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CONSUMER EXAMINER'S GUIDE

June/1981

NATIONAL CREDIT UNION ADMINISTRATION
WASHINGTON, D.C. 20456

NCUA 8103

CONSUMER COMPLIANCE
EXAMINATION

WORKING
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FOREWORD

The purpose of the Consumer Examiner's Guide is to provide examination procedures that will enable the consumer examiner to determine an FCU's compliance with the various consumer laws and regulations applicable to Federal credit unions. Where the term "examination" is used in this Guide, it refers to consumer compliance examinations.

The Consumer Examiner's Guide is an internal NCUA publication. Its contents are not to be shared with persons outside NCUA without the express written consent of the Office of Consumer Affairs or the National Credit Union Administration Board.

This Guide will be kept current by means of numbered changes which will be issued as needed.

GENERAL

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1. INTRODUCTION

Federal credit unions (FCUs) must comply with various Federal statutes and regulations which are primarily consumer-oriented. The National Credit Union Administration (NCUA) is responsible for enforcing compliance with these consumer laws as they apply to Federal credit unions. This enforcement responsibility includes providing training and guidance to credit union officials and employees as well as detecting violations. The consumer compliance examination is the principal method by which NCUA accomplishes this important responsibility.

Federal credit unions are chartered to serve a specific field of membership (FOM). People falling within this FOM may join the credit union and become a member/owner. These members are the consumers protected by the consumer laws and regulations. Compliance with consumer protection legislation is consistent with the purpose for which Federal credit unions are chartered. Noncompliance, on the other hand, may not only result in inequitable treatment of members, but also may subject the credit union and/or its officials and employees to severe civil liability, the possibility of reimbursement for Truth in Lending underdisclosures, and (in rare cases of intentional violations) criminal penalties.

1.1 CONSUMER COMPLIANCE EXAMINATION OBJECTIVES AND PURPOSES

The purpose of the consumer compliance examination is not to seek out and "punish" a credit union and its officials for noncompliance with the consumer regulations. Instead, through consumer compliance examinations, NCUA hopes to assist credit union officials and employees in understanding the requirements of the laws and regulations, thereby achieving a greater degree of compliance. High levels of compliance will benefit both credit unions and their members. The specific objectives and purposes of the consumer compliance examination are as follows:

a. To determine the degree of the credit union officials' and employees' understanding of the various consumer laws and regulations.

b. Where deficiencies in understanding are noted, to make provision for the necessary training and instructions.

c. To determine that the credit union's employee training programs, forms, policies, and procedures are adequate to achieve compliance with the laws and regulations.

d. To determine whether the credit union is in compliance with all applicable consumer protection laws and regulations.

e. To determine that the credit union and its officials are not engaging in any questionable practices and/or depriving any members of their membership rights and privileges.

f. Where exceptions/violations are noted, to determine their basic causes and develop reasonable plans for correction.

g. To reach agreements with appropriate officials and key employees for timely correction of any exceptions/violations, including reimbursement or other appropriate affirmative action.

h. To make a full, detailed and meaningful report on the consumer compliance examination findings to the NCUA Board, part of which will be provided to the credit union's board of directors.

1.2 SCHEDULING CONSUMER COMPLIANCE EXAMINATIONS

In scheduling examinations, the consumer will consider the following:

a. The date of the last consumer compliance examination;

b. The asset size of the credit union;

c. The seriousness of the problems, if any, noted during the last examination;

d. Administrative actions, if any, being taken against the credit union;

e. Complaints filed against the credit union;

f. Location;

g. Approximate time needed to conduct the examination; and

h. Other factors which might affect the advisability of postponing or advancing the examination date in a particular case.

Unless prior clearance is received from the Chief of Consumer Affairs, an examination will not be scheduled if any of the following conditions exist:

The Chief of Consumer Affairs, with assistance from the Chief of Supervision and Examination, will periodically keep consumer examiners advised of the necessary information to comply with "b" above. At times, this information may not be known by the examiner until after the examination is scheduled or started. If so, the examination should be rescheduled if possible without an undue travel cost or loss of time. In most cases where the examination has been started, it will be preferrable to continue with the examination after clearance is obtained from the Chief of Consumer Affairs. In all cases where the necessary clearance has been obtained from the Chief of Consumer Affairs, an explanatory comment will be provided in the Closed Section.

Where credit unions are scattered and considerable travel is involved, the scheduling of examinations should be coordinated in the interest of effective supervision and economy.

Since the examinations of smaller credit unions (under $2 million in assets) will be conducted in a relatively short period of time, it will generally be preferrable to conduct these examinations while examining a larger credit union. For example, the intial contact could be made with the smaller credit union, and while the officials and employees are obtaining the necessary forms, policies, minutes and loan files for review, the examiner could start the examination of the larger credit union. Because of travel time this procedure will not be possible unless the credit unions are located in close proximity to each other.

At times, an examiner will have to make an on-site investigation of a member complaint. If possible, the examination should be conducted in conjunction with the complaint investigation.

For various reasons including cross-training purposes, a consumer compliance examination may be conducted in conjunction with the financial examination. These joint examinations will be scheduled by the Chief of Consumer Affairs and the Chief of Supervision and Examination and/or the appropriate Supervisory Examiner. The consumer examiner will not schedule and conduct joint examinations on his or her own initiative.

Considering the above comments, the examiner should give priority in scheduling examinations in each of the following situations:

a. Initial Consumer Compliance Examinations - the initial examination of a newly-chartered Federal credit union will be conducted within months of the initial contact performed in accordance with section "S" of this Guide.

b. Examinations of:

(1) Credit unions with assets of $10 million or more.

(2) All credit unions in which very serious consumer regulation problems (as determined by the consumer examiner and/or Chief of Consumer Affairs) were noted during the previous examination. These will generally be credit unions with serious violations of Regulations Z, B and/or E.

c. Credit unions with the oldest effective date of previous examination.

d. Complaint Investigations - Examinations may be scheduled in conjunction with complaint investigations if authorized by the Chief of Consumer Affairs.

It is the policy of NCUA to perform a consumer compliance examination of all Federal credit unions during each three-year period. If it is necessary to defer the examination of any credit union, those deferred should be under $2 million in assets with few, if any, consumer regulation problems. Also, credit unions included in the priority categories mentioned above do not absolutely have to be examined before other credit unions. The examiner will take into consideration all criteria mentioned in this section when scheduling examinations.

1.3 ADVANCE NOTICE

It is NCUA policy to provide Federal credit unions with ample notice of plans to conduct any consumer compliance examination. This will facilitate the timely performance of the examination. A standard advance notice letter, NCUA 3301, has been developed for this purpose. The letter informs the credit union of the purpose of the examination and outlines the forms, policies, minutes, etc. needed by the examiner to perform the examination.

The examiner will send the advance notice letter to the credit union within two to four weeks prior to the scheduled start of the examination. In most cases, it is also advisable to call the treasurer or manager of the credit union approximately one week prior to the start of the examination. In rare cases where advance notice is not possible, the reason(s) why will be detailed in the Closed Section.

At times, the examiner may be unable to conduct an examination as scheduled. In such cases, the examiner will, by telephone, promptly advise the credit union of the change in examination plans unless the examination will be performed within 3 to 5 days of the previously scheduled date.

1.4 PRE-EXAMINATION ANALYSIS

Prior to starting the examination, the examiner will become familiar with the credit union's background and will review:

a. The previous two consumer compliance examination reports, including all work papers;

b. Membership complaints filed since the previous examination;

c. All correspondence applicable to consumer affairs between the credit union and NCUA since the previous examination; and

d. Available information concerning the credit union's FOM as documented in the charter and bylaws. The location of the credit union records, its business hours, availability of directors and committee members, and type of operations should also be considered by the consumer examiner in planning for the examination. The overall objective of this pre-examination analysis is to determine what problems, if any, are likely to be encountered. Time spent in the pre-examination analysis will be charged to the same time code as examinations.

1.5 ESTABLISHING RAPPORT WITH OFFICIALS AND EMPLOYEES

Immediately upon starting the examination, the examiner should, if possible, contact (individually or in a group) the following officials and key employees: president (or vice-president), treasurer, manager and chairperson of both the supervisory committee and the credit committee (or other available committee members). The purpose of this initial contact is to inform them of the start of the examination, the purpose of the examination, the possibility of the need for separate meetings with them and their respective committees, and that the examiner is available to answer questions and provide other assistance, as needed.

In dealing with the officials and employees, the examiner should show genuine interest in the welfare of the credit union and its members. He or she should be neither too friendly nor too aloof. The examiner must conduct himself or herself with professional dignity and be tactful, considerate, and courteous at all times. All criticism should be constructive. Recommendations should be realistic and have substance.

1.6 EFFECTIVE DATE OF THE CONSUMER COMPLIANCE EXAMINATION

The effective date of the examination will be the date on which the examination is commenced. In cases where the books have not been closed for the prior month, it may be necessary to adjust loan selection procedures to be able to adequately identify the loan population. For example, if the examination is started on April 20 and the books have been closed for the month of March, the effective date of the examination would be April 20. If the books were not closed for March but were closed for the month of February, it may be necessary to use certain information and documents with a February 28 (or 29) effective date. If so, this will be discussed in the Closed Section.

At times, the records may be in arrears for at least the two months preceding the date the examination is commenced. The fact that the records are seriously in arrears could very well hinder the timely completion of the examination. Also, such a problem usually warrants the prompt attention of the district financial examiner. In such cases, the examiner will contact the Chief of Consumer Affairs and discuss the advisability of postponing the examination.

1.7 TEAM CONSUMER COMPLIANCE EXAMINATIONS

Team consumer compliance examinations are those with two or more consumer examiners participating (except for those involving only the OJT trainer and the trainee examiner). With assistance from the Principal Consumer Examiners, the Chief of Consumer Affairs will schedule all team consumer compliance examinations in the region. Team examinations will be scheduled for the following reasons:

a. To facilitate the timely completion of examinations of larger credit unions (usually those with assets of over $40 million);

b. To provide special assistance for those credit unions with particularly serious problems;

c. To provide Principal Consumer Examiners with supervisory experience;

d. To act as a training method for examiners who will be observing and working closely with the Principal Consumer Examiners and/or the Chief of Consumer Affairs; and

e. To allow examiners to work together in order to share experiences and discuss and observe different ways of performing the various examination steps.

A schedule of planned team examinations will be prepared by the Chief and distributed to examiners by March 1 and September 1 of each year. The schedule will cover the respective six-month period beginning on April 1 or October 1 of each year. The schedule will include at least the following data: Name and charter number of FCU, location, examination commencement date, approximate number of days needed to complete the examination, and the name of the Examiner in Charge (EIC) and participating examiners. As soon as practical, the Chief will notify affected examiners of any changes in the schedule. At times, however, the Chief may have to schedule team examinations with little prior notice to participating examiners.

In most cases, the EIC will be a Principal Consumer Examiner. From two to four weeks prior to the start of the team examination, the EIC will coordinate with all participating examiners the following: (a) lodging plans, (b) exact date and time of commencement of examination, (c) plans for any pre-examination conference, and (d) projected time each examiner will be needed on the examination. As needed, the EIC may also provide the team members with their respective assignments, thereby eliminating the need for a pre-examination conference. The EIC will be responsible for coordinating any necessary lodging reservations and transportation to and from the credit union. The time used by the EIC in this preliminary work will be charged to WWC 08, Supervision-CE.

The EIC must be able to direct and coordinate the efforts of all the participants. He or she has complete responsibility for the team examination. Although the end product of the examination will be the result of the team's efforts, the completed report will bear the name of the EIC, and will represent his or her findings, conclusions, and plans for action. Therefore, the EIC must keep in touch with all facets of the examination as it progresses. He or she should determine the scope of the examination and make all assignments to other team members or group leaders. Normally, contacts between the team and credit union officials and employees should be through or with the knowledge and approval of the EIC.

The EIC, in making the pre-examination analysis and in designing procedures to fit a particular examination, should keep the basic examination and supervisory concepts in mind at all times. Once the examination is started, the EIC will normally participate in the more important aspects of the work in order to assure performance of an effective examination. During the entire examination, the EIC should maintain contact with all phases of the work, and team members should be released as conditions and the progress of the examination permit. Before each examiner is released, the EIC should review the work of that examiner, determine that all assignments have been completed, and make certain that notes and work papers are legible and understandable. Any conclusions reached and/or recommendations suggested should be conveyed to the EIC by the examiner at that time.

Teams should be kept as small as is feasible considering the job to be performed. Small teams ordinarily produce a more efficient examination and at the same time permit the EIC to obtain a more comprehensive knowledge of the credit union. Normally the team will consist of only two or three examiners.

Parent organization security restrictions must be considered in scheduling team examinations. In some government installations and private organizations, advance security clearance is required. Occasionally, security restrictions may cause undue delay at the entrance. If examiners must be escorted to the credit union office by a plant guard or by a credit union official or employee, advance arrangements for admittance can usually be made with a member of the supervisory committee. Security restrictions should be discussed in the Closed Section and on NCUA 3006, Consumer Compliance Examination Information Worksheet.

The EIC should plan his or her examinations to ensure that all procedures will be carried out efficiently with as little time lost as possible. In the larger team examinations, the EIC will devise a control record and list of instructions for the participants so that each examiner will be productively engaged in some phase of the examination until released. The EIC will normally appoint group leaders to head up various phases of the examination when there is a large team. The EIC will then be free to coordinate and direct the total examination more effectively.

With good preparation, pre-examination conferences will not be needed except in a relatively few cases. For most team examinations, assignments can be given to team members when they assemble immediately prior to the start of the examination. Although it is intended that all team members enter the credit union office to begin the examination at the same time, there may be large examinations wherein past experience has shown that substantial examination time is lost during the initial phases of the examination, perhaps in gaining access to certain EDP records or waiting for employees to pull files, etc. In these cases, the EIC may begin the examination alone or with one key team member a day or two in advance of the full team. During this advance period, the EIC (and key team member, if any) can survey the operation and set up examination work for the full team. If such an approach is used, it should be commented upon in the Closed Section for purposes of planning future examinations.

It may be desirable in some cases for the team or certain designated key members to assemble for a short conference away from the credit union office prior to the commencement of the team examination. During this conference the EIC may issue specific assignments to each examiner or to those examiners who will serve as group leaders.

Anticipated problems will be covered during the pre-examination conference. Necessary workpapers and other specific instructions, if any, should be issued at this time.

The time spent at pre-examination conferences will be charged to WCC 08, Supervision-CE.

1.8 INITIAL CONSUMER COMPLIANCE EXAMINATIONS

The initial consumer compliance examination of a newly-chartered FCU is important since the guidance and instruction offered by the examiner will help the new officials understand their roles more clearly. If the officials are given proper guidance during the early stages of the credit union's existence, the likelihood of serious problems emerging will be minimized.

The initial examination will be made within   months of the initial contact performed in accordance with section "S" of the Consumer Examiner's Guide. Normal examination procedures will be followed in all initial examinations.

When dealing with the officials and employees, the examiner should maintain a helpful attitude. Harsh criticism should be avoided. Although problem areas should not be overlooked, the examiner should be mindful that the problems probably resulted from inexperience rather than neglect. Therefore, the examiner needs to be especially tactful in discussing the problems, and skillful in developing solutions with the officials.

1.9 RELATIONS WITH FINANCIAL EXAMINER

Cooperation between the consumer examiner and the financial examiner is highly desirable. Such cooperation can result in a meaningful exchange of information and expertise. The consumer examiner should not hesitate to contact the financial examiner during or between consumer compliance examinations to relay information obtained which would be of probable interest to him or her. The consumer examiner may also want to take advantage of the specialized expertise of the financial examiner. Likewise, the consumer examiner should not hesitate to assist the financial examiner when he or she has questions or problems in the area of consumer laws and regulations. The consumer examiner will keep the Chief of Consumer Affairs advised of any significant information or questions received from the financial examiner. Also, the consumer examiner will normally contact the Chief of Consumer Affairs prior to relaying significant information or questions to the financial examiner. In such cases, it may be preferable for the Chief to contact the respective Supervisory Examiner.

During a consumer compliance examination, the credit union may indicate that a noted exception/violation was caused by following instructions received from the financial examiner. In such cases, the consumer examiner will not automatically assume that the financial examiner erred, since such problems are usually the result of misunderstandings. In most cases (depending upon the materiality of the problem), the consumer examiner will contact the Chief of Consumer Affairs for guidance.

WORKPAPERS

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2. GENERAL

Various workpapers and checklists have been developed for use during the examination. Their design and use are intended to accomplish the following:

a. Promote uniformity of examination procedures throughout NCUA.

b. Provide the examiner with efficient procedures and methods for determining the credit union's compliance with the various consumer laws and regulations.

c. Facilitate the review and processing of the report and work papers in the regional office.

d. Support the examiner's findings and agreements included in the examination report, provide evidence that sound examination procedures were followed, and substantiate the effectiveness of the work performed.

In certain instances, the standard workpapers may not be entirely appropriate and the examiner may have to make modifications to provide more meaningful information. Some procedures may call for the examiner to develop a workpaper of self-design. If so, seven column worksheets, NCUA 2142, should be used.

A listing of all workpapers and forms, and their order of assembly in the report appears in section 31 of this Guide. Instructions for completion of the workpapers appear in various sections of this Guide and/or on the reverse side of the workpaper.

2.1 SCHEDULES

At times, it may be advisable for one or more standard workpapers or examiner-designed workpapers to be included in the formal report to the credit union to support an area of concern in the open section. If so, the examiner will assign a schedule number in numerical order beginning with number one. The examiner will prominently print in the heading of the form, "Schedule No. _____". The workpaper will then be assembled in the report as directed in section 31 of this Guide. Schedules should be used only when absolutely necessary since they will cause an increase in regional office processing time. Also, they should be double spaced to facilitate editing in the RO.

2.2 CONSUMER COMPLIANCE EXAMINATION NOTES

Legible examination notes will be maintained by the examiner as the examination progresses. These notes will usually contain comments on possible exceptions observed, items to be checked further, and special points that are to be discussed later with employees or officials. Those exceptions that are recorded immediately upon their discovery on other examination workpapers need not be duplicated in the examiner's notes. These notes should be submitted along with other workpapers to the regional office with the examination report. They frequently help to clarify questions that arise in the review of the report in the regional office. In order to provide uniformity, ruled sheets or the seven column worksheets referred to in section 2. should be used for recording these notes.

It is usually helpful in preparing an agenda for any meetings to "head up" several notesheets with major topical headings and to list all related matters thereon. However, the examiner may prepare his or her notes in the style or manner which is most appropriate.

2.3 CONSUMER REGULATIONS COMPLIANCE CHECKLIST AND SUMMARY, NCUA 3323 and 3324

The Consumer Regulations Compliance Checklist and Summary are the main consumer compliance examination workpapers to be used by the examiner in reporting the degree of the credit union's compliance with the various consumer laws and regulations. These workpapers will be used for the following purposes: (a) as a guide for the examiner, (b) as a tool to train credit union officials and employees, (c) as a method of providing the officials and employees with both documentation and explanations of the exceptions/violations noted during the examination, (d) as a means of following up on the correction of noted exceptions/violations, and (e) as the input document into NCUA's EDP system. The specific instructions for completing and distributing NCUA 3324, Consumer Regulations Compliance Summary, are on the reverse side of the form. The examiner will use the following procedures when completing NCUA 3323, Consumer Regulations Compliance Checklist:

a. In the portion below each set of questions, reflect relevant comments and information on violations noted on that section of the Checklist.

b. All comments will be grammatically correct and expressed in brief but complete sentences. The comments should be typed. If handwritten, the writing or printing must be legible.

c. Indicate the number of the above question which revealed the exception/violation being explained.

The original of NCUA 3323, Consumer Regulations Compliance Checklist, will be given to the appropriate credit union official, usually the president or treasurer. Additional copies may be made and given to the other officials and key employees as deemed necessary. The regional office, Washington office, and examiner copies of the form will be assembled in the examination report as explained in section 31 of this Guide.

2.4 CONSUMER EXAMINER'S FINDING, NCUA 3012

Exceptions and violations noted during the examination which cannot be appropriately reflected on NCUA 3013, Loan Review Results, will be reflected on this workpaper. When completing the form, the following procedures will be used:

a. EXPLANATION OF VIOLATION/COMMENTS - Clearly explain the nature of the exception/violation: Use grammatically correct and complete sentences. The comments should be typed. If handwritten, the writing or printing must be legible. If a similar violation was noted during the previous examination, the comments will be preceded by an asterisk.

b. LAW REFERENCE - Cite the appropriate law reference code(s) and the specific section(s) of the law, rule or regulation.

c. NCUA MANUAL REFERENCE - Cite the appropriate manual reference code(s) and the specific page number(s) of the manual.

d. CORRECTION CODE - Reflect the correction code(s) which represents the recommended and, when possible, agreed-to plan for correction of the violation.

e. Place a check mark (✓) in the last column if the exception/violation is corrected during the consumer compliance examination. If the exception is corrected during the examination, put an "x" in the last column.

NCUA 3012, Consumer Examiner's Findings, will be distributed as indicated on the form.

GENERAL CONSUMER COMPLIANCE EXAMINATION PROCEDURES

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3. GENERAL

The consumer compliance examination of all Federal credit unions will be performed in accordance with the procedures outlined in this Guide. The various conditions under which examinations must be made as well as differences in operating practices within individual credit unions may require the examiner to rearrange the sequence of steps at the start of the examination. Many factors may influence this consideration, including the size and type of credit union, type and condition of records, timely availability of certain forms, policies and procedures, availability of officials and employees, etc. The examiner must be flexible enough to adapt to the circumstances and perform an effective examination with a minimum of lost motion. However, the examiner should bear in mind that the sequence of the examination steps has been developed to gain important information about the credit union as soon as practical after the contact as well as to result in the most generally efficient examination format overall.

3.1 SUGGESTED ORDER OF EXAMINATION STEPS

a. Make initial contact with the president, treasurer, manager, and chairperson of both the supervisory and credit committees, section 1.5.

b. Obtain and/or request the forms, policies, minutes, etc. outlined in the advance notice letter, NCUA 3301.

c. Select and provide the appropriate officials or employee with a list of the loans to be reviewed in the random statistical sample, section 15.1.

d. Review the board of directors and executive committee meeting minutes and prepare NCUA 3014, Board of Directors and Executive Committee Minutes, section 9.

e. Review the lending policies and discuss them with appropriate officials and/or key employees. Prepare NCUA 3021, Lending Policies, and when necessary, NCUA 3022, Lending Policies and Procedures, section 10.

f. Review all advertising and prepare NCUA 3026, Advertising, section 11.

g. When necessary, review HMDA-1 data and discuss with appropriate officials and employees the procedures for complying with HMDA and Regulation C, section 23.

h. Review the credit union forms and complete appropriate form review workpapers, section 14.

i. Perform the random statistical sample review of approved loans and complete NCUA 3028, Profile of Loans, section 15.

j. If necessary, perform the selected sample review of approved loans and complete NCUA 3028, Profile of Loans, section 15.

k. Determine the demographic characteristics of the "typical majority applicant" and identify the minority applicants, select and review the rejected loan applications, and complete NCUA 3028, Profile of Loans, section 15.

l. Review the debt collection procedures and selected delinquent loans, section 20.

m. Complete NCUA 3013, Loan Review Results, section 2.

n. Complete NCUA 3323, Consumer Regulations Compliance Checklist, section 2.3, and hold any needed meetings with officials and employees, section 3.2.

o. When necessary, complete NCUA 3012, Consumer Examiner's Findings, section 2.4.

p. Complete the remaining sections and mail the examination report to the regional office.

3.2 MEETINGS WITH OFFICIALS AND KEY EMPLOYEES

At the conclusion of the financial examination, the examiner-in-charge (EIC) holds a joint conference with the directors and committee members. Such a joint conference will not normally be necessary at the conclusion of the consumer compliance examination. However, separate meetings with an individual or group of official(s) and/or key employee(s) will usually be necessary during the examination. These meetings will be conducted for the following reasons: (a) to obtain an understanding of the credit union operations and procedures, (b) to explain noted exceptions/violations for training purposes, and (c) to obtain the necessary agreements for corrective action.

Since meetings are time consuming, they should be held only when absolutely necessary. If a number of items are to be covered, prepare an agenda listing the items in logical sequence. The agenda will be in outline form and included with the work papers submitted to the regional office.

When conducting meetings, the following guidelines should be followed:

a. Two-way communications should be encouraged. The examiner should ask questions frequently to be certain that his or her comments are being understood. Those present at the meeting should be invited to participate freely in the discussions.

b. The examiner should not hesitate to compliment the officials for specific achievements such as correction of problems noted during the previous consumer compliance examinations. However, general complimentary statements that may be subject to various interpretations should be avoided.

c. The matters to be discussed should be covered in a logical sequence and in a constructive and positive manner.

d. All agreements, understandings, and target dates should be specific. Assignments of responsibilities for corrections should be clearly understood by those persons involved.

e. If the meeting has been lengthy due to the coverage of many items, the examiner should summarize the matters discussed at the conclusion of the meeting.

3.3 HANDLING EXCEPTIONS/VIOLATIONS

Except as otherwise noted elsewhere in this Guide, all exceptions and violations noted during the examination will be reflected on NCUA 3323, Consumer Regulations Compliance Checklist, and either NCUA 3013, Loan Review Results or NCUA 3012, Consumer Examiner's Findings. Possible "effects test" problems, nonconformance with NCUA guidelines, and questionable (but not illegal) policies or practices will be reflected on NCUA 3010, Supplementary Comments and Recommendations. The exceptions and/or violations will be discussed with the appropriate official(s) and key employee(s). Where possible, the examiner will have any necessary corrective action(s) finalized (or at least partially implemented) during the examination.

All repetitive (noted during last examination) and/or serious violations, will be treated as a major area of concern and the necessary corrective agreements or recommendations will be reflected in the Consumer Compliance Record of Action. The examiner will need to exercise his or her own judgment in determining which violations are serious.

3.3-1 FEDERAL RESERVE BOARD STAFF LETTERS

Throughout the form review work papers to be completed during an examination (and in other printed material and NCUA training), reference will be made to FRB staff interpretation letters. These are letters which the staff of the Federal Reserve Board has written in answer to various questions submitted from interested parties. Copies of pertinent letters have been included in this Guide as appendecies.

FRB staff letters are issued in two forms:

a. Official Staff Interpretations - These letters are designated by the letters "FC" for those relating to Regulation Z and "EC" for those relating to Regulation B. For example, the third official staff interpretation issued regarding Regulation Z is "FC-0003"; the seventh official staff interpretation issued regarding Regulation B is "EC-0007".

Official staff interpretations (OSIs) have the same authority as the regulation which they interpret. This authority is provided by statute. Additionally, in the 1979 Supreme Court case of Milhollin vs. Ford Motor Co., the Supreme Court stated that Federal courts should recognize the expertise of the FRB staff as expressed in its official staff interpretations and be guided by the letters.

b. Public Information Letters - These letters are sometimes known as "unofficial staff interpretations. These letters are identified only by the letters "No." appearing before the number of the letter. For example, the fiftieth public information letter (PIL) written regarding Regulation Z is "No. 50." The same designation would also apply to the fiftieth letter written regarding Regulation B. Therefore, it is important to be certain of the letter's subject before using it as a reference.

Public information letters do not have the same authority as is provided official staff interpretations. However, they do represent the opinion of the FRB staff regarding the addressed subject. Therefore, they are considered very valuable in determining the requirements of applicable regulations.

Both OSIs and PILs may be used by examiners as corroborating evidence and guidance when citing violations of applicable consumer regulations. Any questions regarding the guidance provided in such letters, their applicability and/or their authority should be directed to the Chief of Consumer Affairs.

3.4 ASSIGNING THE CONSUMER COMPLIANCE RATING

a. At the end of each consumer compliance examination, the examiner will assign an individual rating to each consumer law or regulation listed on NCUA 3324, Consumer Regulations Compliance Summary. The individual rating will be one of the following nine ratings as appropriate.

(1) A "0" indicates that the regulation or law does not apply to the FCU.

(2) A "1" indicates that the FCU is in full compliance in all areas at the completion of the examination.

(3) A "2" indicates that the FCU is in non-compliance at the completion of the examination, but that the violation(s) was not noted during the previous consumer compliance examination and is not sufficiently severe to

warrant treatment in the Record of Action.

(4) A "3" indicates that the FCU is in non-compliance at the conclusion of the examination; agreements to correct the problem areas were reached with the officials; the violation(s) was not treated in the Record of Action in the previous consumer compliance examination; and the violation(s) is sufficiently severe to warrant treatment in the Record of Action of this examination.

(5) A "4" indicates that the FCU is in non-compliance at the conclusion of the examination; agreements to correct the problem areas were reached with the officials; the violation(s) was treated in the Record of Action of the previous consumer compliance examination; and the violation(s) is sufficiently severe to warrant treatment in the Record of Action of this examination.

(6) A "5" indicates that the FCU is in non-compliance at the conclusion of the examination; agreements to correct the problem areas were reached with the officials; the violation(s) was treated in the Record of Action of two or more previous consumer compliance examinations; and the violation(s) is sufficiently severe to warrant treatment in the Record of Action of this examination.

(7) A "6" indicates the FCU is in non-compliance at the conclusion of the examination; agreements to correct the problem areas were not reached with the officials; and the violation(s) is sufficiently severe to warrant treatment in the Record of Action of this examination.

(8) A "7" indicates that the FCU is in non-compliance at the conclusion of the examination; Truth in Lending or Equal Credit Opportunity uniform enforcement actions are being taken; the violation(s) will be treated in the Record of Action of this examination.

(9) An "8" indicates that the FCU is in non-compliance at the conclusion of the examination; administrative action is being recommended or continued; the violation(s) will be treated in the Record of Action of this examination.

b. After assigning individual ratings to each consumer law or regulation, the examiner will assign an overall consumer compliance rating to the FCU. The overall rating will be at least as severe as the highest rating assigned to any law or regulation. (A "5" is considered a more severe rating than a "4", etc.) This rating will be recorded in the appropriate place on NCUA 3324, Consumer Regulations Compliance Summary.

f. In addition to the "NCUA overall compliance rating", the FCU's overall compliance with consumer legislation must also be rated in the Federal Financial Institutions Examination Council's (FFIEC) rating scale. This is a 1 through 5 scale as follows:

1. An institution in this category is in a strong compliance position. Management is capable of and staff is sufficient for effectuating compliance. An effective compliance program, including an efficient system for internal procedures and controls, has been established. Changes in consumer statutes and regulations are promptly reflected in the institution's policies, procedures and compliance training. The institution provides adequate training for its employees. If any violations are noted they relate to relatively minor deficiencies in forms or practices that are easily corrected. There is no evidence of discriminatory acts or practices, reimbursable violations, or practices resulting in repeat violations. Violations and deficiencies are promptly corrected by management. As a result, the institution gives no cause for supervisory concern.

2. An institution in this category is in a generally strong compliance position. Management is capable of administering an effective compliance program. Although a system of internal operating procedures and controls has been established to ensure compliance, violations have nonetheless occurred. These violations, however, involve technical aspects of the law or result from oversight on the part of operating personnel. Modification in the compliance program and/or the establishment of additional review/audit procedures may eliminate many of the violations. Compliance training is satisfactory. There is no evidence of discriminatory acts or practices, reimbursable violations, or practices resulting in repeat violations.

3. Generally, an institution in this category is in a less than satisfactory compliance position. It is a cause for supervisory concern and requires more than normal supervision to remedy deficiencies. Violations may be numerous. In addition, previously identified practices resulting in violations may remain uncorrected. Overcharges, if present, involve a few consumers and are minimal in amount. There is no evidence of discriminatory acts or practices. Although management may have the ability to effectuate compliance, increased efforts are necessary. The numerous violations discovered are an indication that management has not devoted sufficient time and attention to consumer compliance. Operating procedures and controls have not proven effective and require strengthening. This may be accomplished by among other things, designating a compliance officer and developing and implementing a comprehensive and effective compliance program. By identifying an instituition with marginal compliance early, additional supervisory measures may be employed to eliminate violations and prevent further deterioration in the institution's less than satisfactory

compliance position.

4. An institution in this category requires close supervisory attention and monitoring to promptly correct the serious compliance problems disclosed. Numerous violations are present. Overcharges, if any, affect a significant number of consumers and involve a substantial amount of money. Often practices resulting in violations and cited at previous examinations remain uncorrected. Discriminatory acts or practices may be in evidence. Clearly, management has not exerted sufficient effort to ensure compliance. Its attitude may indicate a lack of interest in administering an effective compliance program which may have contributed to the seriousness of the institution's compliance problems. Internal procedures and controls have not proven effective and are seriously deficient. Prompt action on the part of the supervisory agency may enable the institution to correct its deficiencies and improve its compliance problems.

5. An institution in this category is in need of the strongest supervisory attention and monitoring. It is substantially in noncompliance with the consumer statutes and regulations. Management has demonstrated its unwillingness or inability to operate within the scope of consumer statutes and regulations. Previous efforts on the part of the regulatory authority to obtain voluntary compliance have been unproductive. Discrimination, substantial overcharges, or practices resulting in serious repeat violations are present.

The FFIEC ratings coordinate with the NCUA ratings as follows:

(1) If NCUA code "1" or "2" is assigned, FFIEC code "1" will be assigned.

(2) If NCUA code "3" is assigned, FFIEC code "2" will be assigned.

(3) If NCUA code "4" or "5" is assigned, FFIEC code "3" will be assigned.

(4) If NCUA code "6" or "7" is assigned, FFIEC code "4" will be assigned.

(5) If NCUA code "8" is assigned, FFIEC code "5" will be assigned.

g. The following guidelines will also be applied when assigning the NCUA compliance rating:

(1) If a pattern and practice of violations subject to the TiL or ECOA/FH Uniform Enforcement Policy is identified during an examination and corrected during the examination, NCUA code "7" will be assigned. This is necessary to properly reflect uniform enforcement actions for NCUA reporting purposes.

(2) If isolated violations (not patterns and practices) subject to the TiL or ECOA/FH Uniform Enforcement Policy are identified during an examination, code "7" is not mandatory. The FCU may be rated as if no Uniform Enforcement action was necessary. This also is necessary to properly reflect uniform enforcement actions for NCUA reporting purposes.

MEMBERSHIP RIGHTS AND PRIVILEGES

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4. GENERAL

A Federal credit union is a cooperative association owned and controlled by its members. The credit union is organized to promote thrift and make loans to members for provident and productive purposes. Credit union members have certain rights and privileges authorized by law and regulation (e.g., FCU Act) in addition to those provided by the various consumer laws and regulations.

Members also have the obligation to accept the responsibilities inherent in being a member/owner of their credit union. The more important of these responsibilities are as follows:

a. To elect capable officials from the membership;

b. To assure democratic control of the credit union by attending and taking an active part in the election process;

c. To be willing to serve as a credit union official if capable or as a member of some operating committee, when needed;

d. To promote credit union membership to those persons within the defined FOM;

e. To repay all loans as agreed;

f. To comply with all operating policies and procedures established by the credit union officials; and

g. To keep the credit union informed of his or her current address (Article XIX, Section 7 of the FCU Bylaws).

4.1 LISTING OF MEMBERSHIP RIGHTS

The various membership rights and privileges are mainly provided in the Federal Credit Union Act and Bylaws and in the National Credit Union Administration Rules and Regulations. Some of the more important rights are listed as follows:

a. If within the FCU's defined field of membership (FOM), a potential member has the right to apply for credit union membership in accordance with the procedures in Article II of the Bylaws. The potential member also has the right not to be denied membership for a discriminatory, arbitrary, or capricious reason. If membership is denied, the potential member has the right to be given a written reason for denial upon request (Section 113 of the Federal Credit Union Act).

b. The member has the right to retain his or her membership unless one or more of the following occurs:

(1) The member withdraws all shareholdings in the FCU (FCU Bylaws, Article II, Section 4).

(2) The member leaves the FCU's defined FOM and fails to meet the minimum standards for membership retention (if any) which were in effect at the time the member left the FOM (FCU Bylaws, Article II, Section 5).

(3) All of the member's shareholdings are absorbed by a late charge in accordance with FCU Bylaws, Article III, Section 3. (The shareholdings may be absorbed if the total share balance remains below the amount [usually $5.00] and for the time period [usually 2 years or 6 months] specified in the Bylaws.)

(4) The member is expelled by a two-thirds vote of the members present at a special meeting called for that purpose, but only after the member has been given an opportunity to be heard (FCU Act, Section 118 and FCU Bylaws, Article XVI).

c. The member has the right to unrestricted access to shareholdings (on the FCU's days of business) unless one or more of the following applies:

(1) The board has envoked a written notice requirement (of up to 60 days) due to a liquidity crisis (FCU Bylaws, Article III, Section 5(a)). (In accordance with NCUA policy, this authority cannot be used by the board in an effort to limit numerous small share withdrawal requests. While the notice period is in effect, no member may obtain a share withdrawal.)

(2) Funds paid in under a payroll deduction plan and not yet credited to the member's share account (FCU Bylaws, Article III, Section 5 (b)).

(3) The member's shareholdings have been specifically pledged as required security on a loan (FCU Bylaws, Article III, Section 5(c)). The amount of shareholdings in excess of the loan balance may be withdrawn. (Refer to NCUA Instruction No. 4630.2.)

(4) The member is delinquent on a loan with the FCU (Article III, Section 5(d)). However, the amount of shareholdings in excess of the delinquent loan balance may be withdrawn.

(5) The member is a comaker, endorser, or guarantor on the delinquent loan of another FCU member (See FCU Bylaws, Article III, Section 5(d)). The amount of shareholdings in excess of the delinquent loan balance may be withdrawn.

(6) The member's membership has been terminated in accordance with Article II, Section 5 of the FCU Bylaws (member left the defined FOM) and the member has a primary or contingent liability to the credit union.

d. The member has the right to have his or her shareholdings left intact. The credit union can apply a member's shares against his or her loan obligation only:

(1) with the member's express permission,

(2) when shares have been pledged as security and the loan is in default (shares may be transferred only if contract or state law specifically authorizes or court judgement is obtained), and/or

(3) upon proper exercise of the FCU's statutory lien on shares (FCU Act, Section 107(11)). Proper exercise of the statutory lien will require that a court judgment be obtained first, unless appropriate state or local law specifically provides for self-enforcement (See Board of Directors' Manual, page 3 and Credit Manual, page 29).

e. The member with financial problems has the right to obtain assistance from the FCU (see FCU Bylaws, Article IX, Section 6; Credit Manual, chapter 5; and Board of Directors' Manual, page 33).

f. The member has the right to inspect the board of directors' minutes and the FCU's charter and bylaws (see FCU Bylaws, Article XIX, Section 6). The member's inspection must be made in good faith and for a proper purpose.

g. In general, the member has the right to have equal access to all services offered by the credit union.

h. The member has the right to equally participate in the election of FCU officials by:

(1) being properly notified of any annual or special meeting of the general membership in accordance with Article V, Section 2 of the FCU Bylaws, and

(2) having one vote the same as all other members (see FCU Bylaws, Article VI, Section 5).

The board may establish a minimum voting age of not more than 16 years of age, per Article VI, Section 7 of the FCU Bylaws.

i. The member has the right to have all personal information and transactions with the FCU kept confidential except as permitted by Article XIX, Section 2 of the FCU Bylaws.

j. The member has the right not to be intentionally or unintentionally subjected to unfair or deceptive practices. See section 5 of the Guide for a more complete discussion.

4.2 CONSUMER COMPLIANCE EXAMINATION PROCEDURES/HANDLING EXCEPTIONS

While performing the various examination steps, the examiner will need to remain constantly aware of the membership rights outlined in section 4.1. This is particularly important during the review of advertising, loan policies, board and/or executive committee minutes and while performing the loan review. In so doing, the examiner should be able to detect any policies, procedures, and/or practices which may directly or indirectly deprive one or more members of their rights and privileges.

Any noted exceptions will be discussed with the appropriate officials and key employees and properly reflected in the examination report. In most cases, the examiner should be able to have the exceptions corrected during the examination by either the establishment, modification, or rescission of a policy or procedure. If not so corrected, firm agreements for prospective corrective action will be obtained. In some cases, it may also be appropriate to rectify a particular harm caused to a specific member or groups of members. The agreements reached will be reflected in either the Closed Section or Record of Action.

4.3 REFERENCES - STUDY GUIDES

a. Federal Credit Union Act: Sections 101(1); 103; 107(5)(A) and (B), (6), (10), (11), (12) and (15); 109; 110; and 118.

b. Federal Credit Union Bylaws: Article I, Section 2; Article II; Article III; Article V; Article VI; Article VII, Section 8; Article IX, Sections 6, 7 and 8, Article X, Section 5; Article XII; Article XVI; Article XIX, Section 2, 6 and 7.

c. Board of Directors Manual for Federal Credit Unions: Part I, pages 1-8; Part II, pages 26 and 27 under "Thrift Promotion" and "Loans"; Part III, pages 33-34.

d. Credit Manual for Federal Credit Unions: Page 2 under "Confidentiality of Transactions"; pages 28 and 29 under "Credit Union Shares" and "Pledge of Shares Requirement", and Chapter 5.

e. National Credit Union Administration Rules and Regulations: Sections 701.22, 701.23, 701.30, 701.31; and Part 721.

SPECIAL RECOMMENDATIONS

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[redacted]

SPECIAL RECOMMENDATIONS

5. GENERAL

This part of the examination addresses certain problem areas in FCU operations that previously were not covered during examinations. NCUA has identified several practices which, although technically legal, are of questionable merit in the credit union context. (These will be referred as "questionable practices".) When they are found to be in use, the consumer examiner will recommend that the FCU voluntarily stop using them. In addition, there are several recommendations which, when applicable, the examiner will make to help improve the FCU's service to its members and to keep its operations consistent with the cooperative principles that are the cornerstone of the credit union movement.

NCUA is discouraging the use of questionable practices for the following reasons:

1. To promote the fair treatment of members and to improve member relations.

2. To reduce member complaints and possible litigation.

3. To promote self-regulation within the credit union movement and thus avoid the need for additional consumer protection legislation that may be considered burdensome to credit union management.

4. To reduce the types of practices that lead to adverse publicity against the credit union movement.

5. To encourage credit unions to maintain their cooperative principles and consumer orientation.

5.1 DESCRIPTION OF QUESTIONABLE PRACTICES

The practices covered in this section are outlined on NCUA 3027, Special Recommendations Checklist. They are discussed in detail below.

a. Exercising contract provisions. There are several loan contract provisions that NCUA considers to be potentially unfair to the member. Many of these questionable provisions are covered in the FTC's proposed Credit Practices trade regulation rule and thus may soon be declared illegal. (Some of these practices are illegal in certain states.)

(1) Assignment of final pay check. This is a type of wage assignment in which the member authorizes the FCU to take the final pay check, in the event the member leaves his or her employment, and apply it to the balance of the loan. The practice usually involves a close relationship between the FCU and the sponsor's payroll office. When an employee is terminated, the payroll office will find out if he or she has a loan with the FCU and, if so, it will place a hold on the final pay check and turn it over to the FCU. The check will then be applied in full to the outstanding loan balance. The check will often include severance pay, vacation pay, sick pay and other fringe benefits, as well as regular wages.

The assignment provision is usually a clause in the loan agreement. However, it may be a separate form that the member signs when the loan is granted. The practice should not be confused with payroll deductions.

NCUA is discouraging the use of this practice for the following reasons:

(a) In many cases the member is unaware of the provision in the contract which calls for the assignment of his or her final pay check, particularly when it is part of the "fine print" of the contract. Thus its use can lead to disputes and complaints.

(b) When exercised, the contract provision is a form of acceleration that the member usually does not contemplate when signing for the loan. The member usually expects to repay the loan in equal installments, not all at once, even in the event of termination of employment.

(c) Taking the final pay check at a time when the member just lost his or her job is especially burdensome on the member. The member often needs and depends on the last pay check to take care of family and household expenses while looking for another job. The final check often includes benefits such as severance pay, paid leave, etc., as well as regular wages.

(d) Loss of employment does not necessarily mean the member will default on the loan. The practice is not a substitute for effective lending policies and collection procedures.

(2) Confession of judgment. This is a clause in the promissory note that authorizes the FCU to obtain a court judgment against the member with no prior notice or chance to object. It also permits the FCU to automatically file a lien against the member's property even though it isn't pledged as security for the loan. The clause is illegal in most states. An example of the clause is given at the end of this chapter.

NCUA is discouraging the use of this clause for the following reasons:

(a) In many cases the member is unaware of the clause, particularly when it is part of the "fine print" of the contract. Even when the member has read the clause, he or she may not understand what it means. Thus its use may lead to disputes and complaints.

(b) The use of the clause deprives the member of his or her "day in court" where he or she may raise legitimate defenses or arrange a court-authorized settlement of the claim.

(c) Using the clause to automatically file a lien against property that is not considered collateral for the loan leads to disputes and complaints about unexpected liens.

(3) Continuing guarantee. This is a guarantee agreement for open end credit that is completely separate from the basic loan agreement. It states that the guarantor agrees to pay "any and all debts" the member may owe the FCU "now or in the future." Thus the guarantor is obligated for any future advances.

NCUA is discouraging the use of this type of guarantee for the following reasons:

(a) The continuing nature of the guarantee may not clearly be disclosed to the member. The member may think he or she is merely "cosigning" for a closed-end loan or the initial advance only. Thus the use of the guarantee may lead to disputes and complaints if the guarantee is exercised in connection with a subsequent advance.

(b) It is questionable whether a credit union should ask a member to sign a document that creates such a sweeping obligation. This type of guarantee is sometimes used in conjunction with commercial credit transactions, but it is questionable whether it should be used for consumer loans, especially where the business sophistication of the average member is often less than that of someone engaging in a commercial venture.

(c) The use of the guarantee may not be a sound form of security for future advances unless the credit of the guarantor is updated for each advance.

(d) For subsequent advances, the credit union may not actually need the guarantor in order to approve the member's application under is standards of creditworthiness. Thus the guarantor may be unnecessary security for the particular advance.

When this practice is found, the examiner will recommend that the officials cease using the statement and, instead, do either of the following: Convert to closed end loans for those members who do not qualify for open end accounts in their own name (or with an acceptable comaker). Or, modify its open end system to allow the guarantor to sign for each future advance. (This will put the guarantor on notice about the continuing nature of the guarantee.)

(4) Acceleration clauses. Some loan agreements contain clauses that declare the loan to be in default if the member leaves the field of membership or leaves employment with the sponsor. These clauses permit the FCU to repossess the collateral or accelerate the note even though the member hasn't missed any payments.

NCUA is discouraging the use of these clauses for the following reasons:

(a) Leaving the field of membership is not in itself a reason to presume that the member will default on the loan. Acceleration should not be a substitute for effective lending policies and collection efforts.

(b) In many cases the member is unaware of the clause, particularly when it is part of the "fine print" of the contract. Thus its use can lead to disputes and complaints.

(c) The member usually contemplates repaying the loan in equal installments, even in the event of leaving the field of membership, and does not expect the credit union to accelerate the balance unless there is a default in payments.

(d) Although similar acceleration clauses have been used by credit unions in the past, they are no longer standard procedure within the consumer loan industry, given the mobility of modern day life.

(e) It is normal for any credit union to expect that some of its members will move or take other jobs during the term of their loans. This should be taken into account when establishing lending policies.

(f) It may be very difficult for the member to get the loan refinanced elsewhere. Thus, acceleration may unnecessarily lead to repossession.

(5) Dragnet clause. This is a provision in the security agreement of a closed end loan that says that the collateral for the loan will automatically secure any future loans as well. For example, assume the member has a signature loan now, but previously had a car loan. If the security agreement for the car loan contained a dragnet clause, the FCU would technically still have a lien on the car and would be able to repossess it if the member defaults on the signature loan.

NCUA is discouraging the exercise of this clause for the following reasons:

(a) In many cases the member is unaware of the clause, particularly when it is part of the "fine print" of the contract. Even when the member has read the clause, he or she may not understand what it means. Thus its use can lead to disputes and complaints.

(b) The member may not be aware of the fact that the collateral in question is in fact pledged when making subsequent loans, particularly if it is not listed in the new security agreement.

(c) For subsequent loans, the credit union often does not need or actually consider the collateral from the previous loan in order to approve the member's application under its standards of creditworthiness. Thus, the collateral may be unnecessary security for the particular loan.

b. State law. The examiner will assure that the FCU officials understand their responsibility to comply with applicable state law regarding repossession and acceleration. Some states require secured creditors to wait a certain period of time before they can repossess collateral. A few states require prior written notice to the debtor before accelerating the note or repossessing collateral. Almost all states require the creditor to store the collateral for a certain period of time after the repossession in order to allow the member to redeem the collateral. A few states prohibit creditors from accelerating the note after the first repossession. A few states prohibit deficiency balances.

If the FCU contracts with a repossession firm, the officials should be reminded that the FCU is ultimately liable for any violations by its agent.

c. Other recommendations. There are four other recommendations that the examiner will make where appropriate to improve the FCU's service to its members and to promote cooperative principles.

(1) Adverse action notices. NCUA has found that some FCUs do an inadequate job of explaining the reasons a member's loan application was rejected. In addition, many members who have tried to contact the FCU for more

information about why the application was rejected or who have tried to request reconsideration of the loan have found that the FCU was not receptive to their request. This, in turn, has led to unnecessary complaints to NCUA. Many discrimination complaints, in particular, have been found by investigation to be the result of ineffective communication on the part of the FCU.

In an attempt to rectify this situation, the examiner will recommend that each FCU set up a program to concentrate on helping members understand why their applications were rejected and to attempt to resolve questions or complaints about the lending process.

The following general guidelines should be recommended, recognizing that not all of them will be feasible in all situations.

Loan policies should be clearly stated and widely publicized. (Note, however, the advertising requirements discussed in section 11 of this Guide.) The procedure for processing loan applications should be publicized, especially the function of the credit committee (including the fact that the committee is made up of elected volunteers) and the function of the loan officers, if any. The FCU should set up a procedure for handling questions or requests for more information about why an application was rejected. When appropriate, the adverse action notice could provide the name and telephone number of the person to contact for more information. The FCU should also set up a procedure to handle requests for reconsideration where the member feels there is information that the credit committee did not consider or where the member can provide additional information to establish his or her creditworthiness. Where appropriate, this procedure could also be reflected on the adverse action notice. The FCU may also want to consider setting up a procedure to allow the member to meet with the credit committee to personally explain his or her financial situation.

In addition, the FCU can provide other assistance to members whose applications were rejected. Members whose applications were rejected due to poor credit reports can be assisted in having any erroneous information corrected. Members can be given debt counseling or can be given advice about creditworthiness and about what steps they can take to improve their chances of being approved in the future.

(2) Complaint handling. NCUA has found that many of the member complaints it receives could have been resolved by the FCUs if they had been more responsive to their members' concerns. To attempt to rectify this situation, the examiner will recommend that each FCU set up a procedure to handle member complaints. The reasons for this are as follows:

(a) It is good member relations.

(b) Credit unions, as cooperatives, need to be especially concerned about being responsive to the needs and problems of their members.

(c) Any organization is subject to operational lapses from time to time. Member complaints are a good way for management to find out where any operational problems are. Complaints can serve as a type of "early warning system" about problem areas.

(d) It will reduce the number of complaints sent to NCUA and minimize our intervention in FCU operations inasmuch as NCUA is obligated to be responsive to complaints it receives from members or their Congressional representatives.

The examiner will recommend that, as a minimum, the FCU establish internal controls to assure that no written member complaints are ignored. For large credit unions, the examiner should recommend the following general guidelines:

(a) The FCU should establish procedures to assure that all complaints are handled expeditiously. (A distinction can be made between complaints and routine inquiries.)

(b) Time frames should be established regarding how long it should take to resolve a complaint. If the complaint cannot be resolved promptly, an interim response should be made.

(c) A log should be kept on all written complaints. Periodic reports should be given to the board of directors regarding the numbers and types of complaints received.

In addition to the above, an FCU can consider appointing a particular person or committee to handle appeals about complaints that were not resolved through normal channels. This can be an ombudsman, a compliance officer, the supervisory committee, or any other person or group that is appropriate to the particular FCU. The existence of the complaint resolution process should be advertised through notices on statements or a sign in the lobby.

Finally, the examiner will instruct the FCU officials that a procedure should be set up to promptly investigate any complaints referred by NCUA. NCUA's complaint handling process should be discussed with officials and any questions answered.

(3) Debt counseling. Article IX, Section 6, of the Bylaws states that the credit committee should assist members with their financial problems. This is also discussed in the Credit Committee Manual. It has long been a part of credit union philosophy for FCUs to provide debt counseling services for their members.

Accordingly, the examiner will generally recommend that each FCU have some capability to provide debt counseling for those members who are having financial difficulties or problems budgeting their money. Information on how to set up these programs is available through trade associations and other sources.

A formal debt counseling program may not be practical for some FCUs, especially very small ones. The examiner should keep in mind that, because of the personal nature of debt counseling, a poorly run program may lead to complaints. In addition, if not handled properly, the FCU could be accused of "discouraging" loan applications as prohibited by Regulation B. Accordingly, the examiner should use discretion in recommending a formal debt counseling program.

As an alternative, many cities have a Consumer Credit Counseling Service, or other similar service, that will assist the member for little or no charge. The FCU may want to consider referring its members to reputable services where they exist. The FCU could also refer members to certain books or pamphlets that may be of assistance to them.

(4) Consumer education. It is also part of long-standing credit union philosophy that credit unions, being self-help cooperatives, should provide consumer education for their members. Accordingly, the examiner will generally recommend that each FCU consider having some kind of a consumer education program for its members. Many FCUs offer lunch-time seminars on such topics as budgeting, wise buying habits, warranties, auto repair, savings and investments. Other FCUs include consumer education articles in their newsletters. Others have a small library for use by their members including books, periodicals such as Consumer Reports and Everybody's Money, used car "blue books" and other pamphlets of interest.

As with debt counseling, a formal consumer education program may be beyond the means of many FCUs. The examiner should use discretion in the amount of emphasis placed on this recommendation.

5.2 CONSUMER COMPLIANCE EXAMINATION PROCEDURES

The examiner will complete NCUA 3027, Special Recommendations Checklist, and use it as a guide for this part of the examination. A copy will not be given to FCU officials.

The examination procedures for special recommendations consist primarily of discussions with key officials or employees about FCU policies and procedures. The examiner will pick the most appropriate person for these discussions. (The examiner should keep in mind that actual operating procedures sometimes differ from stated policy.)

The examiner will not consider it a questionable practice if the FCU has a questionable provision in a loan agreement, provided the FCU does not actually exercise it. If, however, the FCU exercises the provision even once, it will be considered a questionable practice.

Although a review of loan agreements is not required to check for questionable contract provisions, the examiner will be alert for them during the forms review portion of the examination. Similarly, member brochures, notices, or board minutes may reveal examples of complaint handling, debt counseling or consumer education programs or deficiencies to be discussed with officials.

In the area of debt collection, the examiner will follow the procedures in section 20 of this Guide, which includes a sample of delinquent loans and a review of collection forms.

It is contemplated that the Special Recommendations Checklist will be a flexible vehicle that will be changed and up-dated from time to time. Examiners should always be on the lookout for new practices that are unreasonable or possibly unfair to the members. When these are found, the examiner will report them to the Chief of Consumer Affairs in the regional office, where they will be forwarded to the Office of Consumer Affairs.

5.3 HANDLING SPECIAL RECOMMENDATIONS

In order to prevent complaints that NCUA is exceeding its authority, the examiner must make a clear distinction between these recommendations and corrective action that would be required to correct consumer regulation violations.

The examiner will keep in mind that FCU officials may not understand the difference between a recommendation that is voluntary and a suggestion on how to comply with a regulation.

When a questionable practice is found, the examiner will discuss the practice with appropriate FCU officials. The discussion will normally cover the purpose and origin of the practice, how often it has been used, and how many members have complained to the FCU about it. The examiner will then explain to the officials why the practice is considered questionable, and recommend that they stop using it. Since most questionable practices are designed to reduce losses, the examiner should attempt to help the officials come up with some alternative method to achieve their objective without using the questionable practice. (This may not always be possible.)

To assist the examiner in making the recommendations, a special handout has been prepared from the November, 1980 and January, 1981 issues of NCUA Review. This handout (NCUA 3029) explains why the practices are considered questionable, offers alternatives, and emphasizes that the recommendations are voluntary. NCUA 3029 may be given to officials at the examiner's discretion.

In order to make the special recommendations program as effective as possible, the examiner will pick the most appropriate official or employee for making the recommendation. This will be someone who has the authority and motivation to adopt and implement the recommended changes.

The examiner must not attempt to pressure the officials to adopt the recommended changes. The examiner's primary role in this regard is to educate the officials regarding NCUA's policy recommendations. The examiner should not be discouraged if the officials reject a recommendation. Nor should the examiner feel defensive about making a recommendation that will not be enforced. This is a voluntary program designed to have long-term effects by stimulating self-regulation in the credit union movement as a whole.

If the officials have reasons for using a questionable practice that the examiner considers valid, the examiner has the discretion not to make a recommendation. In these cases the examiner will tell the officials that the practice is an area of concern for NCUA and that they should be aware of the controversial nature of the practice, the fact that members may complain about it, and that it may tend to reflect adversely on the FCU or the credit union movement as a whole. Such situations will be documented in the "Comments" section of NCUA 3027, Special Recommendations Checklist.

Similarly, for question #23 (debt counseling program) and question #24 (consumer education program), the examiner has the discretion not to make a recommendation in cases where it would not be appropriate. Generally, this would be for FCUs which have documented financial problems or FCUs which are too small to support such programs. In these cases, the examiner will check the "Not Applicable" block of NCUA 3027.

All questionable practices will be documented on NCUA 3027, Special Recommendations Checklist. If necessary, the practice will be described or clarified in the "Comments" section. When a questionable contract clause is being exercised, the examiner will attach a copy of the loan agreement to NCUA 3027 and circle the provision in question. The RO will forward the agreement to the Office of Consumer Affairs, attached to the original copy of NCUA 3027.

All recommendations made by the examiner in the special recommendations area will be reflected on NCUA 3010, Supplementary Comments and Recommendations, for inclusion in the formal examination report issued by the regional office. A statement that the recommendation is only a recommendation, not a requirement, will be included.

5.4 REFERENCES/STUDY GUIDES

a. Federal Credit Union Bylaws, Article IX, Section 6.

b. Credit Committee Manual, pp. 28-29, 49-52.

FCU ACT USURY PROVISIONS

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APPLICABLE APPENDICES

Appendix 13	IRPS No. 80-10
Appendix 14	NCUA Letter No. 38
Appendix 15	IRPS No. 79-9

8. GENERAL

Section 107(5)(A)(vi) of the FCU Act limits the rate of interest that an FCU may charge on member loans. This section provides that the rate of interest on a loan to a member may not exceed 15 percent per annum on the unpaid balance, inclusive of all finance charges. It also provides that, under certain circumstances, the NCUA Board may increase the maximum rate of interest for periods not to exceed 18 months. Whenever such an increase occurs, an NCUA Bulletin will be issued. The bulletin will contain the new rate and the period during which the new rate will be effective.

An important exception to the general usury provision of the FCU Act is specified in NCUA Interpretive Ruling and Policy Statement (IRPS) No. 80-10 dated October 23, 1980. This IRPS relates to Section 107(5)(A)(iii) of the FCU Act and Section 701.21-5(a) of the NCUA Rules and Regulations and is contained at Appendix No. 13 of this Guide.

IRPS No. 80-10 provides that on government insured or guaranteed loans, an FCU may charge an interest rate in excess of 15 percent on the unpaid balance inclusive of all finance charges if a higher rate is either expressly required or expressly permitted by the laws and regulations governing the insured or guaranteed loan program. (*E.g.*, HUD Title 1 home improvement loans, VA mortgage loans, FHA mortgage loans, etc.)

8.1 DETERMINATION OF FINANCE CHARGES

The NCUA Board has determined that the term "finance charge", as used in Section 107(5)(A)(vi) of the FCU Act, should parallel as closely as possible the computation of the finance charge as set forth in Section 106 of the Truth in Lending Act. Consequently, those charges included (and excluded) from the finance charge determination under Truth in Lending Regulation Z are finance charges (or not finance charges) for purposes of Section 107(5)(A)(vi) of the FCU Act. This position is further discussed in NCUA Letter No. 38 (contained in Appendix No. 14).

8.2 COMPENSATING BALANCES

Interpretive Ruling and Policy Statement (IRPS) No. 79-9 (contained at Appendix No. 15) dated December 12, 1979 defines the term "compensating balance" to be a deposit in a Federal credit union that:

a. the FCU requires that the member/borrower make;

b. is created from either

    (1) part or all of the proceeds of the loan, or

    (2) from any outside source (including the borrower's own funds; and

c. is not accessible to the member/borrower for a given period of time.

IRPS No. 79-9 specifies that it is not intended to address:

a. FCU thrift plans;

b. open end credit;

c. estate loans;

d. prepaid interest; and

e. funds that are withheld from the borrower but not placed in a deposit account or certificate of indebtedness (e.g., escrow accounts).

These areas are undergoing further study.

A compensating balance must be considered in determining the "effective rate of interest" on a loan to an FCU member. By depriving the member of the free use of the funds held by the FCU (the compensating balance), the member has the effective use of a lower amount of funds from the loan. Unless the interest on the loan is reduced correspondingly, the effect is to increase the effective rate of interest collected by the FCU. In accordance with Section 107(5)(A)(vi) of the FCU Act, the effective rate of interest may not exceed 15 percent per annum (or other rate as established by the NCUA Board).

8.3 REFUND OF EXCESS FINANCE CHARGES

Section 701.21-6(c)(4) of the NCUA Rules and Regulations requires recomputation for repayment of real estate loans involving points or finance charges. Since the term the loan was outstanding may impact the effective rate of interest, the FCU must assure that the effective rate of interest for the period the loan was outstanding does not exceed that provided in the FCU Act. If necessary, a refund to the member must be made to ensure that the usury limit is not exceeded. This requirement (not to exceed the usury limit) also applies to all other loans.

8.4 CONSUMER COMPLIANCE EXAMINATION PROCEDURES

During each examination the examiner will determine whether the FCU is in compliance with Section 107(5)(A)(vi) of the FCU Act. This will be accomplished by verifying the effective rate of interest for all loans reviewed under sections 15.1 and 15.2 of this Guide.

8.5 HANDLING VIOLATIONS

Violations of Section 107(5)(A)(vi) will almost always be treated as a major area of concern and an appropriate Record of Action developed. The only exception is for an isolated violation which the examiner determines was a clerical or other error and is unlikely to recur. If the examiner believes there is any likelihood of recurrence, a Record of Action will be developed. For isolated violations, the violation will be cited on NCUA 3012, Consumer Examiner's Findings.

The Chief of Consumer Affairs will be contacted and informed of the usury violations. The examiner should refer to section 16.6 of the Guide (Truth in Lending - Handing Reimbursable Violations) for the types of information which the Chief may wish to discuss. Prospective correction action (eliminate the procedure causing the violation) will always be required. Any other corrective action (e.g., reimbursement to the members) will be dictated by current NCUA policy. The Chief will have the most current information regarding this area.

Compliance or violations will be reflected on NCUA 3323, Consumer Regulations Compliance Checklist and NCUA 3324, Consumer Regulations Compliance Summary.

8.6 REFERENCES - STUDY GUIDE

a. Federal Credit Union Act - Sections 107(5)(A)(vi) and 113.

b. Federal Credit Union Bylaws - Article VII, Section 2.

c. National Credit Union Administration Rules and Regulations - Section 701.21-1(b) and Section 701.21-6(c)(4).

d. Credit Manual - pages 19 and 39 - 40.

e. Accounting Guidelines for Real Estate Lending, NCUA 8054.

f. NCUA Interpretive Ruling and Policy Statement No. 79-9.

g. NCUA Interpretive Ruling and Policy Statement No. 80-10.

h. NCUA Letter No. 38 (1980).

BOARD OF DIRECTORS AND EXECUTIVE
COMMITTEE MEETING MINUTES

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BOARD OF DIRECTORS AND EXECUTIVE
COMMITTEE MEETING MINUTES

9. GENERAL

The board of directors is responsible for the general direction and overall control of the credit union. The board members are elected by the general membership for either two or three year terms. The total number of directors must be an odd number of not less than five nor more than the maximum number specified in Article VII, Section 1 of the Federal Credit Union Bylaws. The executive officers of a Federal credit union must be board members and are elected by the board. The executive officers are the president, one or more vice-presidents, secretary, and treasurer.

The board is responsible for the credit union's program management, administrative management, and financial management. This includes, but is not limited to, establishing lending policies, developing a thrift promotion program, establishing loan collection policies and procedures, approving the offering of optional services to the general membership, and establishing personnel policies. In carrying out these functions, the board meets at least monthly and sometimes more frequently. The meetings are conducted in accordance with Robert's Rules of Order and meeting minutes are carefully prepared by the secretary.

Due to the board's many duties and responsibilities, the board may find it necessary to establish various standing and/or special committees, such as:

executive committee, budget committee, personnel policies committee, delinquent loan committee, and educational committee. The executive committee, which is authorized by Section 113 of the Federal Credit Union Act, must be made up of not less than three directors and may exercise any authority delegated to it by the board.

9.1 REVIEW OF MINUTES

Prior to or immediately upon starting the examination, the examiner will request copies of the minutes of meetings of both the board of directors and the executive committee (if any) held since the previous examination. When obtained, the examiner will promptly review the minutes. It is important for this review of minutes to be conducted prior to the "Review of Forms" and "Loan Review" portions of the examination, if at all possible.

The main purpose of the review of meeting minutes is to familiarize the examiner with policies and procedures established by the board (and/or executive committee if any) which have a bearing on the performance of certain portions of the examination. During this review, the examiner will pay particular attention to any actions taken in the following areas:

a. Lending policies and procedures,

b. Delinquent loan collection policies and procedures,

c. Insurance activities,

d. Group purchasing activities other than insurance, and

e. Policies affecting membership rights and privileges granted by law or regulation, such as membership requirements for members leaving the defined

FOM.

Pertinent information concerning any of the above areas will be transcribed on NCUA 3014, "Board of Directors and Executive Committee Meeting Minutes". When completing NCUA 3014, the examiner should complete the columnar information about a specific meeting only when commenting on business conducted during the meeting. The examiner's comments on the work paper need not be in complete sentences or grammatically correct but must be legible and readily understandable. Any informational comments which will be transcribed on another examination schedule or workpaper should be underlined.

9.3 REFERENCES - STUDY GUIDES

a. Federal Credit Union Act - Sections 107(5), (10) and (11); 111; 112; and 113.

b. Federal Credit Union Bylaws - Article II, Sections 2 and 5; Article III, Sections 2 and 4; Article V; Article VI; Article VII; Article VIII; Article XII, Sections 2 and 7; and Article XIX, Section 4.

c. National Credit Union Administration Rules and Regulations - Sections 701.21-1, 701.21-2, 701.21-3, 701.21-5, 701.21-6, and Part 721.

d. Board of Directors Manual for Federal Credit Unions - Particularly Part II.

LENDING POLICIES

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10. GENERAL

As stated in Section 101 of the Federal Credit Union Act and Article I, Section 2 of the Federal Credit Union Bylaws, one of the two purposes of a Federal credit union is to provide members with an economical source of credit for provident and productive purposes. Also, as stated in Section 107(5)(A) of the Federal Credit Union Act, loans to members shall be made in conformance with criteria established by the board of directors.

As a minimum, the written lending policies of the board of directors must include: (a) the secured loan limit, (b) the unsecured loan limit, and (c) the interest rates according to the specific loan classifications identified in Section 701.21-1 of the NCUA Rules and Regulations. Most boards, however, go beyond these minimum requirements. This is because the establishment of sound lending policies is an effective and important part of financial management. The lending policies established by the board must not only be sound, but must be practical and realistic and should be tailored to meet the specific needs of both the credit union and its members. Additionally, the policies should prescribe standards of creditworthiness to be used in uniform credit evaluation.

When establishing lending policies, the board attempts to reduce loan losses by making little, if any, credit available to members with present or potential financial problems. Although this is both desirable and permissible for the credit union and its members, policies sometimes inadvertently prohibit certain groups of creditworthy members from obtaining credit. This is, of course, always undesirable and sometimes illegal. For this reason, lending policies must be carefully reviewed during the examination. Lending policies are also reviewed to determine if the credit union is affected by certain consumer laws and regulations, such as RESPA, Fair Credit Reporting Act, Regulation C, Fair Housing, Flood Insurance, etc.

10.1 CONSUMER COMPLIANCE EXAMINATION PROCEDURES

Prior to or immediately after starting the examination, the examiner will request a copy of the credit union's written lending policies and any credit scoring systems used. These policies (and scoring systems, if any) will be reviewed after the scan of the board and executive committee minutes, section 9, and prior to the review of advertising, section 11, and the loan review, section 15. After the review, the examiner will transcribe on NCUA 3022, Lending Policies and Procedures, any policies and procedures which are not reflected in the written lending policies.

The lending policies will be reviewed to determine compliance with the consumer laws and regulations and fairness to all credit union members. This review will be conducted by using NCUA 3021, Lending Policies. This work paper was designed to facilitate the review by concentrating on known problem areas and providing explanations where needed. NCUA 3021 will be prepared as discussed in the Review of Forms portion of this Guide, section 14.2, Preparation of Workpapers. NCUA 3021, Lending Policies, NCUA 3022, Lending Policies and Procedures, and a copy of the written policies and credit scoring systems will be assembled in the examination report as outlined in section 31 of this Guide.

10.2 HANDLING EXCEPTIONS/VIOLATIONS

All exceptions will be discussed with the appropriate officials and key employees. During the discussion, the examiner will first determine why the policy was enacted. This will, in most cases, enable the examiner to develop a reasonable, acceptable alternative policy or procedure. The examiner will then explain the exception/violation and offer his or her recommendations. It is important for the examiner to demonstrate a sincere concern for the operation of the credit union and the difficulties faced by the officials in developing both sound and fair lending policies..

When possible, the necessary corrective action will be implemented during the examination. The corrective action will generally involve the rescission or modification of the old policy and enactment of a new policy or procedure. The exceptions will be reflected on either NCUA 3012, Consumer Examiner's Findings or NCUA 3323, Consumer Regulations Compliance Checklist. For all repetitive and/or serious violations, the plans for corrective action will be reflected in the Record of Action.

As noted on NCUA 3021, Lending Policies, certain policies may have the effect of discriminating on a prohibited basis or may be legal but unfair. Exceptions in these two areas will also be discussed with the officials as previously explained but will not be treated as an exception on NCUA 3012, Consumer Examiner's Findings, NCUA 3323, Consumer Regulations Compliance Checklist or in the Record of Action without concurrence from the Chief of Consumer Affairs. Instead, the nature of these exceptions and recommended corrective actions will be reflected on NCUA 3010, Supplementary Comments and Recommendations.

10.3 REFERENCES AND STUDY GUIDES

a. Federal Credit Union Act - Sections 101, 107(5), 109 and 113.

b. Federal Credit Union Bylaws - Article I, Section 2; Article XII.

c. National Credit Union Administration Rules and Regulations - Sections 701.21-1 and 701.21-4(e)(2).

d. Credit Manual for Federal Credit Unions - Pages 10-47.

e. Board of Directors Manual for Federal Credit Unions - Pages 2 (LOANS TO MEMBERS), 18-20 (POLICIES AND PROCEDURES), and 26-28 (LOANS).

f. Manual of Laws Affecting Federal Credit Unions - Parts 2 and 4.

ADVERTISING

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11. GENERAL

Advertising is essentially the act of bringing a product or service to the attention of the public usually through the use of announcements, displays or notices. Advertisements may be oral or written and may be relayed through any medium of communication including newspapers, magazines, radio, television, signs, posters, statements of account, credit union publications, etc. Although only the larger credit unions use advertisements extensively, almost all credit unions use some form of advertisements occasionally. For the smaller credit unions, advertising will usually only consist of posting or otherwise making written loan policies available to the members.

There are basically seven laws and regulations which regulate advertisements in credit unions. These are identified and briefly explained as follows:

a. Regulation Z (Truth-in-Lending Act) - Section 226.10 covers all advertising of loans, both open-end and closed-end. If certain "trigger terms" are used, specific disclosures must appear clearly and conspicuously in the advertisement.

b. Federal Fair Housing Law and Section 701.31 of the NCUA Rules and Regulations - prohibits discrimination in advertising real estate related loans and requires Equal Housing Lender disclosures, where applicable.

c. Section 701.35 of the NCUA Rules and Regulations - covers requirements in advertising share accounts, share draft accounts, and share certificates.

d. Part 740 of the NCUA Rules and Regulations - covers requirements concerning the advertisement of insured status.

e. Section 701.38 of the NCUA Rules and Regulations - covers advertisements of certificates of indebtedness (borrowed funds from natural persons).

f. Regulation B (Equal Credit Opportunity Act) - Section 202.5(a) prohibits discouraging loan applicants on a prohibited basis.

All advertisements by credit unions must comply with the above laws and regulations, if applicable. The credit union may not in any advertisement make any representation which is inaccurate or in any way misrepresents its services, contracts, investments, or financial condition.

11.1 CONSUMER COMPLIANCE EXAMINATION PROCEDURES

Prior to or immediately after starting the examination, the examiner will request a copy of all credit union advertisements. When making the request, the examiner will need to give examples of all usual forms of advertisements used by credit unions. This is necessary because the officials and employees may not view certain items, such as messages on statements of accounts or posted lending policies, as advertisements. If available, the examiner will request scripts or tapes of any radio, television or other recorded messages if replay facilities are available.

Once obtained, the examiner will review the advertisements (or representative samples) for compliance with applicable laws and regulations. When possible, this review will be made after the Review of Lending Policies, section 10, and prior to the Loan Review, section 15. When performing the review, the examiner will use NCUA 3026, Advertisements. This work paper is a useful guide to the requirements of the various laws and regulations. NCUA 3026 will be prepared as discussed in the Review of Forms portion of this Guide, section 14.2 Preparation of Workpapers.

11.2 HANDLING EXCEPTIONS/VIOLATIONS

All exceptions will be discussed with the appropriate officials and key employees. When possible, the necessary corrective action will be implemented during the examination. In most cases, prospective corrective action will be sufficient. The exceptions will be reflected on either NCUA 2523, Consumer Regulations Checklist or NCUA 3012, Consumer Examiner's Findings. For all repetitive and/or serious violations, the plans for corrective action will be reflected in the Record of Action.

11.3 REFERENCES/STUDY GUIDES

a. National Credit Union Administration Rules and Regulations - Sections 701.31(d)(1)(i) and (ii); 701.31(d)(2); 701.31(d)(3); 701.35(k); 701.38(a)(3); and Part 740.

b. Regulation Z (Truth-in-Lending) - Sections 226.2(d), 226.6(a), and 226.10.

c. Manual of Laws Affecting Federal Credit Unions - Part 1, Section M, and Part 4.

REVIEW OF FORMS

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REVIEW OF FORMS

14. GENERAL

In order to determine compliance with some of the consumer laws and regulations, particularly Regulations Z, B, and E and Section 701.35(k) of the NCUA Rules and Regulations, the examiner will need to carefully review the forms used by the credit union. The importance of this review and the necessity for the forms to be in full compliance with the various consumer laws and regulations cannot be overemphasized. A single violation on a form will usually result in numerous individual violations and may subject the credit union to liability in a class action suit.

Credit unions use a variety of forms in conducting day-to-day business with the membership. There are accounting forms (generally not of concern to consumer examiners), loan forms, and forms relating to the various share accounts and share certificate accounts. If properly designed, the forms accomplish important objectives: (a) they provide legal evidence of transactions, (b) they facilitate adequate credit analysis, and (c) they help to assure compliance with the various consumer laws and regulations. In fact, loan forms are key factors in complying with the requirements of the Equal Credit Opportunity and Truth in Lending Acts.

Credit unions will generally obtain necessary forms from state leagues or from one of the other suppliers of accounting supplies and forms. These national suppliers are listed on the reverse of the "NCUA Publications

List". Some credit unions will also use forms supplied by insurance companies (loan forms) and data processors (statements of account). Even though forms are obtained from a league or other supplier, it is the credit union's responsibility to ensure that the forms are in full compliance with the Federal Credit Union Act, applicable state laws, and federal consumer laws and regulations. The FCU officials should be aware of what precautions the supplier has taken in the area of assuring compliance with the applicable laws and regulations. If the supplier has obtained a written legal opinion, a copy should be maintained on file by the credit union. The examiner will need to ensure that the FCU officials are aware of their responsibilities in this important area.

Occasionally, a credit union will design its own forms or modify a form obtained from a supplier or from another credit union. Since the development of any form, especially a loan form, is expensive and requires considerable expertise, the examiner normally will not encourage this practice. For all promissory notes and other lien instruments, the credit union should have a written attorney's opinion on file stating that the form is in compliance with the Federal Credit Union Act and applicable state contract laws and that the credit union will be able to enforce collection in the courts. For any credit union-designed form, the examiner should also encourage that a written legal opinion as to the form's compliance with the applicable consumer laws and regulations be obtained and kept on file. Credit unions should be informed, however, that such forms must actually be in compliance with all applicable laws and regulations and that a legal opinion will not fully protect them if the forms are later found to be in violation.

14.1 REVIEW PROCEDURES

Prior to or immediately after starting the examination, the examiner will request a copy of certain forms currently used by the credit union. The types of forms which will be requested are as follows:

a. Loan applications,

b. Regulation Z disclosure forms (both closed-end and open-end),

c. Statements of account,

d. Adverse action notices,

e. Closed-end notes, security agreements, and other lien instruments,

f. Open-end and line-of-credit loan agreements,

g. Regulation E disclosure forms (initial, periodic, and terminal), and

h. Standard disclosure statements for each class or type of share account and share certificate account offered by the credit union.

Once obtained, the pertinent information will be recorded on NCUA 3006, Consumer Compliance Examination Information Worksheet.

The examiner will first determine if forms used by the credit union have been previously reviewed by NCUA. Examiners will periodically be furnished with a list of forms that have been reviewed by NCUA. The list will include the respective form numbers and dates, descriptions and specific areas of non-compliance, if any. If a form is reflected on the list, the examiner will: (a) review the form to the extent necessary to ensure that any modifications by the credit union are not violative of the applicable consumer laws and regulations; and (b) handle any noted violations (caused by FCU modifications or as reflected on the list of forms) in accordance with section 14.3, Handling Violations, of this Guide. It will not be necessary to submit a copy of the form with the examination report unless exception is taken to any credit union modifications.

For all other forms (except the NCUA model loan application), the examiner will conduct a comprehensive consumer compliance review. This review of forms will, if at all possible, be accomplished after the review of the board's meeting minutes and loan policies and prior to the loan review. During this form review, the examiner will primarily be concerned with compliance with the various consumer laws and regulations and Sections 701.31 and 701.35 of NCUA's Rules and Regulations. However, if exceptions are noted with other NCUA requirements (FCU Act, Bylaws, NCUA Rules and Regulations, and NCUA Manuals), they will be brought to the FCU officials' attention. For example, the examiner may note that a line-of-credit agreement does not comply with the requirements of Section 701.21-3 of the NCUA Rules and Regulations.

14.2 PREPARATION OF WORKPAPERS

The forms will be reviewed by using the appropriate form review workpapers. These workpapers were designed to assist examiners in the review process and to provide for a detailed record of the review. The workpaper must be fully completed. A separate workpaper will be completed for each different form reviewed. For example, if an FCU has two closed end disclosure forms, a separate workpaper will be completed for each of the two disclosure forms. Upon completion of the review, a copy of the form will be attached to the workpaper and included with the examination report. For the Regulation Z disclosure forms, a copy of the applicable loan note or open-end agreement and other pertinent lien instruments (e.g., security agreement) will also be attached to the workpaper.

The heading of each workpaper contains both form and supplier identification information and is basically self-explanatory. It is important for the examiner to determine, as well as possible, the extent of use of the form. This will determine what action(s), if any, the regional and Washington offices will take concerning any noted violations. If the form is used by other credit unions, the regional or Washington office will contact the key representative of the supplier at the address reflected on the workpaper.

Specific references and explanations (where necessary) for the items in the "Form Review Requirements" column are reflected on the reverse side of the workpaper. In the "Compliance" column, the examiner will indicate the degree of the form's compliance with each item in the "Form Review Requirements" column as follows: Y (yes - in compliance), N (no - not in compliance), Q (questionable - may not be in compliance), NA (not applicable). Exceptions or violations caused by the credit union's procedures will not be reflected on this workpaper. For example, FCU employees may be improperly completing a form or the credit union may not have all necessary types of forms. These violations will be noted while performing other examination steps (primarily during the loan review) and will be reflected on other consumer compliance examination workpapers.

At times, the examiner may not be able to determine compliance with a particular item until a discussion has been held with credit union officials and/or operating personnel, additional examination steps have been completed or further research or discussion with the Chief of Consumer Affairs has been conducted. In such cases, the item will be checked "questionable" until a final determination can be made. Except in rare cases, all questionable items will be cleared by the end of the examination.

The "Comments" column is for the examiner's own use. This column will generally be used when a further identification or explanation of the violation is needed. The comments do not have to be grammatically correct but should be legible and readily understandable by the regional office reviewer.

The workpapers were designed to capture all possible violations with applicable laws and regulations. However, in some cases, it may not be possible to reflect a particular exception/violation on the form as presently designed. If so, the examiner may modify the workpaper or attach an additional sheet of paper, as needed.

14.3 HANDLING OF VIOLATIONS

There are basically two types of violations on forms. One type can only be corrected by developing and printing a completely new form. The other type can be temporarily corrected by making modifications to the current supply of the form. After a violation is noted, the examiner will need to determine the type of violation. This will have a direct bearing on the recommendations to be made to the FCU officials.

After the violation and type are noted, the examiner will, if at all possible within a reasonable period of time, develop a realistic recommendation as to how the form should be corrected. The examiner will not, however, make recommendations as to the modification of any legal document. The examiner must remember that it is neither the examiner's nor NCUA's responsibility to develop loan forms for FCUs. As previously mentioned, the development of a loan form is a very time-consuming task. On occasion, the complexity of the violations and/or the number of the violations will prevent the examiner from being able to inform FCU officials of exactly how to correct a particular form. In such cases, the examiner will: (a) clearly explain the nature of the violation(s), (b) remind the officials of their responsibilities in this important area, and (c) explain to them that various forms are available from state leagues and other suppliers of forms. The examiner will not, however, recommend any particular form, although various suitable forms may be identified.

After the type of violation has been determined and realistic recommendations for correction have been developed (if possible), the examiner will discuss the violations with the appropriate FCU officials and/or operating personnel. This discussion should be held as soon as possible after the violations have been noted so that all available methods of correction, both temporary and permanent, may be considered and possibly implemented prior to the conclusion of the examination. During this discussion, the examiner may be able to obtain the necessary agreements for correction. In any case, firm corrective agreements will be obtained prior to the conclusion of the examination. In most cases, the agreements will direct the credit union to immediately correct the current supply of forms or obtain and start using a corrected form. A temporary supply of a correct form can sometimes be obtained from another credit union or a supplier in a relatively short period of time.

In those rare cases where the current supply of forms cannot be corrected and a new correct form cannot be obtained immediately, firm agreements will be reached with the officials to obtain a correct form as soon as possible, but in no case should this be longer than 90 days. In such cases, the FCU board will need to decide whether or not to use the incorrect form until the new form is obtained. The examiner will need to explain to the FCU officials that: (a) any use of a form that is not in compliance could subject the credit union to severe civil penalties in the case of a lawsuit; and (b) in specifying a period of time to correct the violation NCUA does not mean to infer that the Federal government is granting the FCU a temporary exemption from the requirements of the particular law or regulation. If the FCU will be temporarily continuing to use a form that is not in compliance, the FCU will also need to notify its surety. In the Closed Section, the examiner will discuss: (a) the reason(s) why the form could not be corrected immediately, (b) the board's decision on temporary continued use of the form, and (c) the reason(s) for the board's decision.

A form violation, no matter how insignificant in appearance, is of major concern due to the resultant number of probable individual instances of violation. Therefore, the corrective agreements reached will be reflected in the Record of Action section of the examination report. The Record of Action will specifically identify all noted areas of violation and will usually contain steps for both the temporary and permanent correction of the form problem.

As discussed elsewhere, all "questionable" areas of compliance should be cleared prior to the end of the examination. However, this may not always be possible. In such cases, the examiner will discuss with the Chief of Consumer Affairs how to handle the questionable items. In most cases, the questionable items will not be discussed with the officials. In the Closed Section of the examination report, the examiner will: (a) explain the nature of each questionable item, (b) discuss the substance of any discussions with the Chief of Consumer Affairs, and (c) outline the recommended plans for corrective action if the questionable item is finally determined to be in violation. Sometimes a form may contain both questionable and non-questionable violations. In such cases, both types of violations will be handled as previously discussed except that the questionable items will usually be discussed with the FCU officials but the credit union will not be required to develop or obtain a new form until a final determination is made on the questionable items. The final determination on the questionable items will usually be relayed to the FCU officials on NCUA 3201, Regional Office Comments and Recommendations.

14.4 SPECIAL PROBLEMS - REGULATION Z

A primary goal of the Truth-in-Lending Act is to achieve uniformity in disclosure of terms to facilitate credit shopping. Therefore, the Act and its implementing Regulation Z require the use of specific terms when making the required disclosures. These terms are enclosed within quotation marks (" ") in the regulation. When reviewing disclosure forms and statements of account, the examiner must keep in mind that the required terms must be used exactly as reflected in the regulation. The examiner should also be aware of the following guidelines/opinions:

a. When the regulation requires the use of a term consisting of more than one word, the required words may not be separated with descriptive words or phrases. For example, Section 226.7(b)(1)(v) requires the use of the term "periodic rate". It would be a violation to disclose "Periodic (daily) rate".

b. If descriptive words or phrases are used in conjunction with a required term, the required term must appear more prominently or be distinguished in some way from the descriptive word(s). This could be accomplished through the use of bolder print or larger type for the required term or by placing the descriptive word(s) in parentheses. For example, Section 226.8(d)(4) requires the use of the term "finance charge". Disclosing "TOTAL FINANCE CHARGE" would be a violation while "Total FINANCE CHARGE" would be acceptable.

c. Regulation Z permits the disclosure of the plural or singular version of some required terms. When permitted, this is specified in the regulation or subsequent FRB staff interpretation letters. For example, Section 226.7(b)(1)(v) permits the use of either the term "periodic rate" or "periodic rates", as applicable. However, when the regulation or interpretation specifies either the singular or plural version of a term, only that version may be used. For example, Section 226.8(d)(3) requires the use of the term "finance charge"; therefore, disclosing "finance charges" would be in violation. There is, however, one exception. Section 226.7(b)(1)(iii) requires the use of the terms "payments" and "credits"; however, FRB staff has stated that the terms "payment" and "credit" can be used to describe an individual payment or credit entry.

Section 226.6(a) requires that the terms "Finance Charge" and "Annual Percentage Rate" be printed more conspicuously than other required terminology. This is a judgmental area in which the examiner must exercise caution before citing a credit union for violation. When examining for compliance with this requirement, the examiner should be aware of the following guidelines/opinions:

a. The two terms must be printed more conspicuously only when required to be used. It is, however, acceptable to print the two terms more conspicuously whenever they are used.

b. The two terms only have to be printed more conspicuously than other required terminology. The terms do not necessarily have to be more conspicuous than other words or phrases which are not required to be disclosed. As a cautionary note, however, other words or phrases must not obscure or detract attention from any required disclosures per Section 226.6(c).

c. In most cases, the two terms are made more conspicuous through the use of bolder type, larger print or offset color. The FRB staff has ruled that asterisks (preferably two before and after) may be used to make the two terms more conspicuous provided that no other words or phrases are either set off by asterisks or of bolder type or larger print. The FRB staff has also ruled that printing the two terms entirely in capital letters complies with the "more conspicuous" requirement providing the other required terminology are printed in lower case letters. (The first letter of a word may be capitalized.)

d. Two other (probably less desirable) ways to make the two terms more conspicuous are: (1) underlining the two terms (however, one court ruled this to be a violation stating that the "underlining" was not a part of the printing process), and (2) using a color-coordinated scheme to emphasize the two terms (this was ruled acceptable by a court).

Section 226.6(a) requires that all disclosures must appear, "clearly, conspicuously, and in a meaningful sequence". This is an extremely judgmental area. The examiner must exercise caution when citing a credit union for violation. When determining compliance with this area, the examiner should be aware of the following guidelines/opinions:

a. "Clear and conspicuous" basically means that the required disclosures must be reflected in such a manner that a reasonable person would notice the disclosures. For example, the disclosures should not be buried in fine print.

b. "In meaningful sequence" basically means that related terms must be presented in an order which will assist the member (borrower) in understanding their relationship. "Related terms" are only those terms which have an arithmetical relationship to each other, e.g., the items specified in Section 226.8(b), (c) and (d). The "order" of the disclosures does not mean a rigid concept of arithmetical progression (horizontal or vertical order, summation or subtractional method). An arrangement of elements which is suitable for one type of transaction may not be adequate for another type of transaction. Reference FRB Staff Letter Nos. 780, 1047 and FC-0054.

Section 226.6(c) states that additional information and explanations may be supplied with the required disclosures provided such information does not mislead or confuse the member (consumer) and does not contradict, obscure, or detract attention from the required disclosures. This is another area in which the examiner will need to exercise caution. The requirements of this section must be met when the open-end or closed-end disclosures are combined with the loan agreement or promissory note and when share account transactions and/or closed end loan transactions are reflected on the statement of account with open end credit transactions.

LOAN REVIEW

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APPLICABLE APPENDICES

Appendix 11 General Information on Sampling

NOTE - Other Loan Review areas are contained in the following Guide sections.

20.2	Debt Collection - Consumer Compliance Examination Procedures
21.4	Equal Credit Opportunity Act (Regulation B) - Consumer Compliance Examination Procedures

15. GENERAL

The loan review is the most important phase of the examination. By performing a careful and complete review of both approved loans and rejected loan applications, the examiner should be able to determine the degree of the credit union's compliance with the various consumer regulations. Before conducting the loan review, certain preliminary examination procedures will be performed, if at all possible. These procedures are as follows:

a. Review the previous examination report and related workpapers, section 1.4.

b. Review any correspondence, particularly complaint letters, relative to consumer matters in the examiner's field file.

c. Review the board of directors and executive committee meeting minutes, section 9.

d. Review written lending policies, section 10.

e. Review advertising, section 11.

f. Review forms, section 14.

g. Review HMDA data, section 23.

The loan review will be conducted in three phases, in the following order:

a. Systematic random sample of approved loans,

b. Selected sample of approved loans, and

c. Judgmental sample of rejected loan applications.

Before starting the loan review, the examiner will need to determine, through discussions with officials and/or key employees, the appropriate procedure to use in conducting the systematic random sample. As soon as possible, the examiner should determine the method of selecting the loans to be reviewed so that other examination steps can be completed while the loan files are being pulled.

15.1 SYSTEMATIC RANDOM SAMPLING - APPROVED LOANS

Systematic random sampling is a scientific sampling technique. A basic principle that must be respected in systematic sampling is that each loan in the defined population must have an equal chance of being selected for review. By loan sampling, the examiner hopes to learn a great deal about the credit union's loan activity by reviewing only a small number of approved loans. Although the term "systematic random sampling" usually causes a person to visualize complicated mathematical concepts and formulas, conducting a systematic sample with a random start is actually a simple process. The procedures to be used by the examiner in conducting a systematic random sampling of approved loans are listed in step-by-step order as follows:

Step 1. Determine the number of loans in the defined population. The population will consist of all loans made during the period immediately preceding the effective date of the examination. For example, if the examination started on the population would consist of all loans made from In the event it is difficult to isolate loans made from other than a previous month end, the population can be expanded by isolating loans granted since the beginning of the appropriate month. In the above example, the population could be expanded to include loans granted from

Step 2. Determine the number of loans to be reviewed. For credit unions with total assets of less than $2 million as of the effective date of the examination, loans will be reviewed. For credit unions with total assets of $2 million or more, loans will be reviewed. In those rare cases where the population (Step 1) contains more than 50,000 loans, loans will be reviewed.

Step 3. Determine the "nth unit". This will be accomplished by dividing the total number of loans in the population (Step 1) by the number of loans to be reviewed (Step 2). The resulting "nth unit" will be the sampling interval. The loans to be selected for review will be every "nth loan".

Step 4. Determine the random starting point. Refer to the table of random digits, Section 15.8. Randomly select a digit from the table (point at a number with a pencil). The number pointed to will be the starting point. If the "nth unit" (Step 3) is from one to ten, the last digit of the number is used; if the "nth unit" is from 11 to 100; the last two digits of the number are used; if the "nth unit" is from 101 to 1,000, the last three digits of the number are used; and so forth.

Step 5. Select the loans to be reviewed. The loans will be selected by using the random starting point (Step 4) and the "nth unit" (Step 3). It makes no difference whether a loan selected is currently outstanding, paid off, or delinquent.

As an example of this procedure, assume that the number of loans in the population (Step 1) is 250. Since the credit union has assets of $4 million, loans (Step 2) must be reviewed. Divide 250 by the result is the "nth unit" (Step 3) or sample interval of To determine the starting point (Step 4), select a random number from the table, and use the last digit of the number unless the number ends in ten, in which case ten would be used as the starting point. Assume number 1045 is selected. The first loan to be reviewed would be loan number in the population; the second loan to be reviewed would be loan number in the population; then loan number and so forth until all loans to be sampled are selected.

Determining the number of loans in the defined population (Step 1) and selecting the loans to be reviewed (Step 5) can usually be accomplished by the use of note numbers. The applicable note numbers should be available from the Journal and Cash Register (JCR), note register, check register, and/or credit committee and loan officer minutes. For example, assume the defined population is from First, obtain the note number of the last loan granted and assigned a note number on Next, obtain the note number of the last loan granted and assigned a note number on Then subtract the note number from the (examination date) note number to obtain the number of loans in the population (Step 1).

In some cases, a credit union may not use a single series of note numbers for all loans granted. Different series of note numbers may be assigned according to collateral type, annual percentage rate, originating branch or other classification. If so, the number of loans granted in each classification during the months preceding the effective examination date will be determined by using the procedure outlined in the preceding paragraph. The individual totals will then be added together to determine the population for review.

Once the number of loans in the population is determined, the examiner will need to select the note numbers of the loan to be reviewed. As an example of this process, assume the "nth unit" (Step 3) is ten and the first note number is 545 and the last note number is 795. If number 1045 is selected from the table of random digits, the first note number to be selected is 549, then 559, and so forth. Different series of note numbers can be placed together (no particular order) and the note numbers of the loans to be reviewed can be selected in the same manner. Once the note numbers are obtained, they should be given to the appropriate credit union operating personnel for the pulling of the respective loan files. In some instances, it may be possible to simply provide the operating personnel with the starting note number and the sampling interval ("nth unit"). Clearance from the treasurer, manager, or responsible supervisor will be obtained prior to soliciting assistance from operating personnel. In cases where such assistance is not available, the examiner will pull the loan files.

In some instances, it may not be possible or preferrable to use note numbers. If so, one of the three following alternative procedures may be used:

Alternate Procedure 1. If the credit union posts disbursements individually in the JCR, the examiner will determine the number of loans granted in the defined population (Step 1) by either counting the individual debits to loans or finding the difference between loans made year-to-date for the period on the credit union's Statistical Report. After the sampling interval (Step 3) and the starting point (Step 4) are determined, the examiner will select which loans to review (Step 5) by counting the debits to loans in the JCR. Since the member's name is entered in the JCR, the loan file can be readily obtained by either the operating personnel or the examiner.

Alternate Procedure 2. If the credit union summarizes disbursements on a daily basis, the examiner will determine the number of loans in the defined population (Step 1) by finding the difference between loans made year-to-date for the period on the credit union's Statistical Report. After the sampling interval (Step 3) and the starting point (Step 4) are determined, the examiner will select the loans for review by counting the loans on the credit union's loan registers for the period. If the credit union does not have loan registers, the examiner will select the loans for review by counting the loans for the period on the loan officer and credit committee minutes.

Alternate Procedure 3. For various reasons, the examiner may not be able to use the note number procedure or alternate procedure one or two. If so, the examiner will need to devise and use some other alternate method. The information in Appendix 11 may be helpful. In some cases, it may be necessary to contact the Chief of Consumer Affairs for advice. The examiner will discuss in the Closed Section the reason the alternate method was used and an explanation of the method.

15.2 SELECTED SAMPLING - APPROVED LOANS

A loan has various characteristics such as collateral, purpose, method of disbursement, whether evidenced by a closed-end promissory note or open-end loan agreement, and so forth. There are particular disclosure and/or other consumer regulation compliance requirements depending on a loan's specific characteristics. Therefore, a list of certain types or classes of loans with different requirements has been developed. These types of loans are listed as follows:

a. Residential real estate first mortgage secured (more than 12 years maturity, if available),

b. Residential real estate second mortgage secured,

c. Chattel secured,

d. Accommodation party,

e. Unsecured,

f. Open-end other than Credit Card (secured or unsecured),

g. Credit Card ,

h. Loan with Credit Life, Health, or Accident Insurance (CDI),

i. Loan with Property Insurance Written in Connection with the Loan,

j. Extension Agreement - Deferral of Payments,

k. Extension Agreement - Change of Terms (Refinancing),

l. Refinanced Loan,

m. Credit Sale - Closed-End,

n. Student Loan - Closed-End,

o. Construction Loan - Closed-End,

p. Loan Drafts - Closed-End,

q. Loan Drafts - Open-End, and

r. Loan that is representative of each type(s) of consumer regulation violation noted during the previous examination.

The systematic random sample should produce most, if not all, of the above various types of loans made by the credit union. However, some loan types, particularly if made infrequently, may not be included in the sample. If so, the examiner will need to review at least nonrepresented type which is made by the credit union. A single loan may be used for more than one loan type, e.g., an unsecured loan with CDI.

Where possible, the loans to be reviewed for the selected sample will be obtained from the previously defined population. However, in some instances, this may not be possible. If so, the time period will be expanded provided it is the credit union's policy to now make or shortly resume making the nonrepresented loan type. For example, the examiner or credit union personnel may be unable to locate a residential real estate loan due to a recent shortage of funds resulting in a temporary suspension of such loans. The examiner will not expand the population if (a) the credit union no longer makes the nonrepresented loan type, and (b) the examiner determines that the credit union will not resume making the nonrepresented loan type at some time prior to the next examination.

When selecting the loans for review, the examiner should request the credit union operating personnel to pull nonrepresented type needed for review. This is advisable since considerable time could be expended by the examiner in searching for a particular type of loan. In some rare instances, neither the credit union operating personnel nor the examiner may be able to locate a loan of a particular type within a reasonable period of time. If so, the examiner will explain to the appropriate officials and/or employees the specific disclosure and compliance requirements for the type of loan not reviewed. An explanation of why such a loan was not reviewed will be recorded in the "Comments" column of the appropriate line on NCUA 3028, Consumer Compliance Profile of Loans.

15.3 JUDGMENTAL SAMPLING - REJECTED LOAN APPLICATIONS

In order to determine compliance with some of the technical/disclosure provisions of the consumer regulations (e.g., Section 202.9 of Regulation B and Section 615 of the Fair Credit Reporting Act), the examiner will need to review some rejected loan applications. Also, rejected applications will be reviewed to detect any possible credit discrimination on a prohibited basis. A complete discussion of examining for credit discrimination using approved loans and rejected loan applications is contained in section 21 of this Guide.

For credit unions under $2 million in assets as of the effective date of the examination, rejected loan applications will be reviewed. For all other credit union's, rejected loan application will be reviewed. The rejected applications will be selected from the period used as the defined population for the systematic random sample. If the required number needed for review were not rejected during the period, the time period will be expanded until either the required number or all loans rejected during the examination period have been reviewed.

15.4 PROCEDURE FOR REVIEW OF LOANS

The examiner should have the following material on hand prior to beginning the loan review: notes, applications, Truth-in-Lending disclosures, collateral and supporting papers, individual share and loan ledgers (or equivalent, e.g. statement of accounts), written lending policies, credit committee and loan officer minutes, NCUA 3028, Profile of Loans, calculator, Manual of Laws Affecting Federal Credit Unions, NCUA Instructions on TiL and ECOA Uniform Enforcement Policies, and other data and material which will facilitate the review of loans. In most cases when a credit union maintains its Individual Share and Loan Ledgers on unit record or electronic computer equipment, the examiner will not have current individual share and loan ledgers available during the loan review. If needed, the transaction information since the last periodic statement of account can be obtained from the credit union's trial balance listings. All approved loans and rejected loan applications reviewed will be:

a. Detailed on NCUA 3028, Profile of Loans;

b. Reviewed for compliance with all applicable consumer regulations, rules and laws;

c. Used to answer the related questions on NCUA 3323, Consumer Regulations Compliance Checklist; and

d. Checked for applicability under the ECOA Uniform Enforcement Policy.

For each loan in the statistical random sample and the selected sample, the examiner will also verify the accuracy of all amounts and percentages on the Truth in Lending disclosure statement. (Refer to Appendix #2.) Particular attention will be given to any exceptions/violations which could result in reimbursement under the TiL Uniform Enforcement Policy. Should questions or problems arise when verifying for TiL reimbursement, the examiner should contact the Chief of Consumer Affairs. With the equipment available in the regional office, the Chief or Consumer Affairs Analyst should be able to handle any calculation problems that arise. It should be noted that the examiner will need to compare the disclosed APR and finance charge to the actual rate being collected by the FCU. E.g., the loan documents could disclose a 12% APR and the correct finance charge and other disclosures while the FCU's computer was using a periodic rate based on 15%. By comparing the actual interest collected on the loan to the disclosure, any inconsistencies will be discovered.

When reviewing rejected loan applications, the examiner will need to give particular attention to the reason(s) for the denial. When necessary, was the member provided with all of the principal reason(s) for denial? Were the reason(s) disclosed to the member the same as those reflected in the credit committee minutes? Were the reason(s) for the loan denial in accordance with the credit union's lending policies? Careful analysis of the reason(s) for loan denial will determine if the credit union is complying with the notice requirements under both Regulation B and the Fair Credit Reporting Act, if applicable, and will sometimes reveal discriminatory practices, if any. NCUA is especially concerned that some credit unions do not adequately convey understandable reason(s) for loan denial to the member. Such a failure by the credit union results in the filing of numerous membership complaints with NCUA. If problems are found in this area, the examiner should explain to the FCU officials that providing understandable reasons for rejection increases member understanding and acceptance and reduces complaints against the credit union.

15.5 COMPLETING NCUA 3028, CONSUMER COMPLIANCE PROFILE OF LOANS

NCUA 3028, Consumer Compliance Profile of Loans, will be used to document the data obtained from the member's loan file for each approved loan and rejected loan application reviewed. It will generally be preferrable to complete the workpaper in pencil. The examiner will fully complete the workpaper by placing the appropriate code, amount, number, check (✓), Y or N, etc. in the various columns. For the most part, NCUA 3028 is self-explanatory. However, for purposes of uniformity the following guidelines will be applied when completing certain portions of the workpaper:

a. Account number, note number columns - provide sufficient information based on the credit unions filing system to allow for identification of the loan files. This could be the account number only in some cases, or a combination with the member's name.

b. Amount - for all amounts requested, show dollars only; omit cents.

c. Date of Loan - show the month, day, year (e.g., 3-12-80) for date of the approved loan or the date on the rejected loan application.

d. Date of First Payment - show the month, day and year.

e. Type of Credit - show an "o" for open end and a "c" for other than open end (closed end).

f. Length of Employment - enter the total number of years with present employer. For military personnel, the total time with the military will be shown. For labor union members where they move from job to job, years of union affiliation will be shown. Retirees will be shown as "R" and unemployed persons shown as "U".

g. INCOME - show the total income as reflected on the loan application.

h. DEBT RATIO - compute and enter the debt ratio. The ratio will be computed using the same income and debts comparison method as used by the credit union. For instance, credit unions use either gross or net income and do or do not include housing costs as part of the debts. The debt ratio for all loans in the credit union will be computed in the same manner. In the first two columns indicate the method of computation.

i. Number of Dependents - may include or exclude the applicant(s). Use the same method used by the credit union and be consistent for all loans and loan applications reviewed.

j. Personal Characteristics - enter all available information. The sex can generally be determined from the applicant's name. Monitoring information, if given, will be reflected. The optional columns are provided for obtaining other characteristics, e.g., race, whenever possible and deemed necessary by the examiner.

k. Outside Credit Information - enter "Y" yes or "N" no, as applicable.

l. Approved by - enter "CC" for credit committee and "LO" for loan officer.

m. Comments and/or Reason(s) for Loan Denial - for all rejected loan applications, reflect the reason(s) for loan denial. The examiner may also want to use this column to record exceptions/violations which will later be reflected on NCUA 3013, LOAN REVIEW RESULTS.

15.6 COMPLETING NCUA 3013, CONSUMER COMPLIANCE LOAN REVIEW RESULTS

NCUA 3013, Consumer Compliance Loan Review Results will be used to reflect exceptions noted with individual loans during the systematic random sample, selected sample, and judgmental sample loan and rejected loan application reviews. All violations noted unless obviously minor and nonrecurring will be reflected on the workpaper. NCUA 3013 should be typed when possible. Instructions are included on the reverse of the form. However, for the most part, the workpaper is self-explanatory. For uniformity, the following guidelines will be applied when completing certain portions of the form:

a. ACCOUNT NUMBER - On accasion it may also be appropriate to enter the member's name is this column if necessary to identify the loan.

b. EXPLANATION OF VIOLATION COMMENTS - the comments will be legible, clear, and grammatically correct. If a similar violation was noted during the previous examination, the comments will be preceded by an asterisk.

c. LAW REFERENCE - reflect the appropriate law reference code(s) and the specific section(s) of the law, rule, or regulation.

d. NCUA MANUAL REFERENCE - reflect the appropriate manual reference code(s) and the specific page number(s) of the manual.

e. CORRECTION CODE - reflect the correction code(s) which represents the recommended and, when possible, the agreed to plan for correction of the violation.

The original of NCUA 3013 will be given to the appropriate credit union official, usually the president or treasurer. Additional copies may be made and given to other officials and key employees as deemed necessary. The regional office, Washington office, and examiner copies of the form will be assembled in the examination report as explained in section 31 of this Guide.

15.7 HANDLING EXCEPTIONS/VIOLATIONS

All exceptions/violations noted during the approved loan and rejected loan application reviews will be discussed with the appropriate official(s) and key employee(s). The exceptions will be reflected on NCUA 3013, Loan Review Results. Appropriate general comments will also be noted on NCUA 3323, Consumer Regulations Compliance Checklist.

When discussing the noted violations with the appropriate official(s), the examiner will recommend reasonable plan(s) for correcting the problem. To the extent possible, the examiner will seek corrective action for the practices causing violations before conclusion of the examination. If corrected, a check (✓) will be placed in the last column of NCUA 3013, Loan Review Results. If not corrected during the examination, the appropriate corrective agreements will be obtained from the officials. For all repetitive and/or serious violations, the plans for corrective action will be reflected in the Record of Action. For other violations, the specific plans for corrective action will be reflected in the "correction code" column of NCUA 3013, Loan Review Results.

15.8 TABLE OF RANDOM DIGITS

06520	67256	21117	09351	98168	81043	29662	90063	96223	30436	21978	15150	56574	15011
36520	99750	38004	64992	25021	45060	46501	92013	99165	29707	44610	53716	54716	17090
52011	54461	06636	23901	31422	13728	35016	80605	90625	21689	33982	29035	[illegible]	41817
09138	77094	26882	15083	45993	29425	12085	96252	29036	91135	28255	27799	[illegible]	09705
25862	81955	17254	28462	93680	42433	70311	06702	71615	72988	85922	56309	[illegible]	06750
60259	07583	81394	66235	48154	61257	27978	61085	63165	44593	08210	16862	09653	00535
38992	97580	79115	47567	73167	47066	57064	16730	74172	60317	83215	38133	06303	05466
04567	64298	71842	97585	32616	23280	11783	19852	64286	21116	11189	77419	30991	92130
09332	86232	85119	66094	72594	30100	23673	68705	66969	12066	81857	34651	36167	24221
42326	62962	06485	04978	96639	96214	91476	12405	21437	19962	99102	91426	10151	51762
49187	42996	17042	35179	31950	48444	59677	50915	37425	21550	25999	64256	82311	19512
09225	37404	42189	07949	98750	31508	78442	45809	12725	49774	11276	46371	81681	00623
69720	73477	91252	46009	81393	76401	48163	25967	33372	84414	21306	46131	48046	12354
82222	13787	95611	95257	34753	38674	44326	66070	61131	70620	42965	89251	54844	04013
30703	00512	34598	05623	43999	55387	67189	95955	91174	13121	27557	16512	77963	40635
86369	02151	70713	41166	79321	52215	94354	29962	35968	22796	87221	40014	65573	71426
83231	99035	66506	96734	91074	21356	03035	66926	32197	54944	76781	66722	11769	27366
43053	60600	96921	43720	77342	26186	64554	46226	64244	10703	49564	69737	32948	43060
57101	19118	18487	01775	71792	04679	64369	06203	71669	63046	10470	54194	96702	86302
33177	11409	13925	18130	54242	13460	39174	63526	22670	31810	04313	50669	20653	31779
05424	76714	05732	29415	01183	45054	13493	44006	61641	80304	96504	52151	05359	72203
92930	58665	41191	69259	50244	55322	75137	90193	31989	17351	43795	26961	15325	02303
54925	20502	71767	82737	64847	04496	35921	42670	08534	54090	52907	75331	09155	54157
41980	43710	55304	57526	29616	92314	85693	21584	55045	81997	62277	55894	01590	13532
83425	70977	67987	61545	92066	71215	93967	63071	69928	95917	05699	35957	04679	58769
84017	93627	37763	07081	33048	57595	42182	73279	09032	19165	01701	35636	03328	81785
12776	69127	67921	57611	85676	30744	40886	68396	79787	76434	71221	86769	15104	19062
81419	55440	69506	09115	45032	48343	78352	39075	31659	76469	64918	15149	88457	97144
59844	03603	96297	58028	93069	35674	38479	54639	54455	10300	73916	94827	53164	07455
18350	74940	07044	11210	53622	00779	36027	51496	01694	57895	84570	18271	54461	42210
79960	18784	13376	03415	84450	78874	22050	19730	92598	54291	60658	78158	03446	49664
45120	24157	16374	22344	56892	84941	97157	99656	33978	81436	10955	96991	10456	35727
13915	09559	68152	56960	39453	51654	10617	55628	47933	85161	52998	75414	59552	03546
91206	33671	60730	96621	95608	29863	39678	73104	43398	38151	44314	58313	28884	94613
24817	08724	81499	72905	95102	63004	22223	19808	90777	54986	97234	18458	22869	63960
94303	08209	27804	49372	66392	50578	02966	90907	33164	83044	97985	78526	00983	29271
22732	95331	60254	93333	71142	38827	48222	21779	35598	95957	58844	82319	19750	08330
82809	24001	65943	01091	70431	91145	88207	52216	94846	75303	85105	89486	08182	56504
62700	79965	09610	97213	48579	43574	37652	12447	80223	42473	94585	94840	90926	74779
89870	73755	48525	32765	50818	71468	37876	28334	07762	16130	45346	76324	20422	85784
81193	24121	67929	12735	41249	24180	51740	44200	58903	38681	04066	69393	84595	42173
43630	32159	08532	43055	08080	84208	06295	07813	24068	67519	43051	76381	02095	03471
60231	18902	13283	96334	39776	07472	25295	07871	34201	49520	52178	07280	89767	63930
00107	21861	60367	48999	71634	34053	28265	02064	06290	10620	17941	81086	51759	57028
09657	36088	05976	88267	62633	57673	85265	10656	06325	37911	52332	55732	25054	30136

TRUTH IN LENDING ACT

(REGULATION Z)

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APPLICABLE APPENDICES

Appendix 7 Selected FRB Letters

NOTE - Additional discussions relating to Regulation Z are located in the following Section of the Guide:

14.4 Review of Forms - Special Problems - Regulation Z

TRUTH IN LENDING ACT (REGULATION Z)

16. GENERAL

The Truth in Lending (TiL) Act is part of the Consumer Credit Protection Act which was enacted on May 29, 1968, with an effective date of July 1, 1969. Truth in Lending primarily pertains to the advertisement and disclosure of the cost and terms of credit. NCUA is designated as the enforcing agency with respect to Federal credit unions. Thus, the Administration must determine that Federal credit unions are complying with all provisions of the Act and the related regulation (Federal Reserve Board Regulation Z). This enforcement responsibility is primarily carried out by consumer examiners during the consumer compliance examination.

Of all the consumer regulations, Regulation Z is the most complicated and generally causes the most concern among Federal credit union officials due to its technical nature. Therefore, it is essential for the examiner to handle any noted exceptions in a sympathetic manner and be prepared to provide the FCU officials with any needed guidance. The proper disclosure forms can usually be obtained by the credit union from its regular source of supplies. If the necessary expertise and legal counsel is available, a credit union may be able to design and use its own disclosure forms. The information provided by the form must satisfy the disclosure requirements set forth in Regulation Z.

16.1 CONSUMER COMPLIANCE EXAMINATION PROCEDURES

Compliance with Regulation Z will generally be determined during: (a) the "Review of Forms: (section 14) and completion of NCUA 3015, 3016, and 30.'; (b) "Advertising" (section 11) and completion of NCUA 3026; (c) the systematic random and selected sample loan reviews; and (d) by answering the related questions on NCUA 2523, Consumer Regulations Compliance Checklist.

Refer to sections 11 and 14 of this Guide and the instructions on the reverse of the respective workpapers when reviewing forms and advertisements for compliance with Regulation Z requirements. Additionally, for each loan reviewed in the systematic random and selected sample, the TiL disclosure form will be carefully reviewed to determine that all required information completed by the FCU staff is properly disclosed. All figures, amounts and percentages appearing on the disclosure statement will be verified for accuracy.

There may be instances where there is no disclosure statement on file for a loan being reviewed. In such cases, the absence of conclusive evidence that a disclosure was provided to the borrower will be treated as a failure to disclose the APR and corrective action under the uniform enforcement policy (see sections 16.2 and 16.3) will be ordered accordingly. However, the credit union will be given the opportunity to prove conclusively that a disclosure was made before reimbursement is ordered. The absence of documentation for loans consummated the later of two years prior to the last consumer compliance examination effective date on or after April 1, 1979 or May 30, 1976, (Section 226.6(i)(2) became effective on May 30, 1978) will be reviewed in relation to known practices of the FCU with respect to record retention and Regulation Z compliance.

16.2 RESTITUTION - SPECIAL EXAMINATION PROCEDURES

Background: On March 31, 1980, the President signed the "Depository Institutions Deregulation and Monetary Control Act of 1980". Title VI of the Act is the "Truth in Lending Simplification and Reform Act". Section 608 of this Act is entitled "Restitution".

Section 608 requires Federal regulatory agencies (including NCUA) to order creditors to make monetary adjustments (restitution) to the accounts of consumers in cases where a disclosure error resulted in an understated APR or finance charge. Section CCE-16.3 summarizes the provisions of Section 608 and provides the enforcement policies uniformly adopted by the five Federal financial institution regulatory agencies (NCUA, Federal Reserve Board, Comptroller of the Currency, Federal Home Loan Bank Board, and Federal Deposit Insurance Corporation).

a. General Provisions

During each consumer compliance examination, perform the loan reviews specified in sections CCE-15.1, 15.2, and 15.4. Open and closed end violations of Regulation Z will be handled as discussed in section CCE-16.6. The restitution provisions of section CCE-16.3 will be followed during this examination step. (Note, however, that the procedures discussed in subsection 16.2.b. of this Instruction will be followed regarding open end credit restitution.) For this examination step, the file search and restitution period will be from the

Note, however, that if a pattern and practice does not exist, restitution will be required for the loan on which a reimbursable violation was detected. However, the officials will not be required to conduct a file search to review for other errors.

b. Open End Credit Provisions

Although Section 608 of the Truth in Lending (TiL) Reform Act requires restitution for closed end and open end credit, procedures for implementing open end credit restitution have not been developed by the Federal Financial Institutions Examination Council (FFIEC). Until such procedures are developed and available for use, examiners will use the following open end credit restitution procedures during examinations.

If violations of Regulation Z and the Truth in Lending Act which may require open end credit restitution are found, restitution will not be required during the examination. The officials will be informed that TiL violations which may require open end credit restitution have been identified. The officials will further be informed that restitution will not be required until uniform enforcement procedures are adopted by the FFIEC. The examiner will refer the officials to Section 130 of the TiL Act for information regarding civil liability. NCUA will provide notification and guidance for open end credit restitution when uniform enforcement procedures are adopted.

The regional director will be notified of possible open end credit restitution by a brief memorandum from the examiner. This memo will discuss the following:

(1) type(s) of violations which may require open end credit restitution;
(2) name and asset size of the FCU;
(3) consumer compliance examination date; and
(4) any other pertinent information.

c. Violations Identified During Preceding Financial Examinations

In addition to the procedures discussed above, the following examination procedures will be followed in the first consumer compliance examination conducted in each FCU after (Note that this procedure will not be followed in subsequent consumer compliance examinations of the same FCU. Also note that the procedures outlined in this paragraph apply to closed end loans only. No review of or restitution for open end credit will be required pursuant to this examination procedure.)

Review the examination reports contained in the field file for any financial examination having an effective date of Determine if any TiL violations which may require restitution are indicated in any portion of the examination report. (This includes the open section of the report and, if available, the Consumer Regulations Compliance Checklist and Summary, Examiner's Findings, Loan Exceptions, and Substandard Loans workpapers.)

If no TiL violations which may require reimbursement are indicated in the examination reports, no file search or restitution will be required as a result of this examination step.

If TiL violations which may require restitution are indicated, the examiner will:

(1) Judgmentally select loans consummated during the period preceding the date of the examination in which the violation was documented. These loans will be those of the type which, in the examiner's opinion, would most probably contain the indicated problem area which triggered the violation. For example, if the FCU requires all unsecured loans to be "backed" by 10% in shares, unsecured loans would be selected. If the FCU was imposing loan origination fees on real estate loans and not adjusting the APR and finance charge, real estate loans would be selected. If the FCU was not adjusting the finance charge for odd first payment periods, loans with "long odd days" would be selected. (If the examination report indicates more than one type of violation (e.g., odd first payment periods and required deposit balances), loans will be selected for each type of violation.)

(2) The review of these judgmentally selected loans will include only the APR and finance charge verification. (This includes verification that proper disclosures for credit life, accident, health and disability insurance were given.) If no reimbursable violations are found, the FCU will not be required to conduct a file search and no restitution will required as a result of this examination step.

(3) If a reimbursable violation is found in any of the judgmentally selected loans, the examiner will determine if a pattern and practice existed at the time the loans were consummated. Since

[redacted]

violations were cited during the financial examination which triggered this review, the procedures discussed in section CCE-16.6 will not be necessary to determine if a pattern and practice exists. This may be accomplished by discussions with the officials, reviewing additional loans or any other method deemed appropriate by the examiner and the Chief of Consumer Affairs.

(4) If a pattern and practice does not exist, restituion will be required for the loan on which a reimbursable violation was detected. However, the officials will not be required to conduct a file search to review for other errors.

(5) If a pattern and practice is found to exist, the officials will be required to conduct an appropriate file search, and restitution will be required for affected loans. As in other restitution cases, the examiner will make reasonable efforts to determine the cause of the violations in order to restrict the file search to the shortest period of time and fewest loans possible. For this examination step, the file search and restitution period will be from

This file search and restitution period is, of course, subject to the provisions of the Truth in Lending Simplification and Reform Act as set forth in section CCE-16.3.

d. Special APR Violation Provisions

In addition to the procedures discussed above, the following special examination procedures will be followed in the first consumer compliance examination conducted in each FCU after (Note that this procedure will not be followed in subsequent consumer compliance examinations of the same FCU. Also note that although the procedures outlined in this subsection apply to both closed end and open end credit, the provisions of subsection 16.2.b. will be followed regarding open end credit.)

(1) Judgmentally select loans consummated in each of the following periods: 1977, 1978, and 1979 and January 1, 1980 through March 31, 1980. These loans may be closed end or open end. For these loans, only the APR will be verified. Therefore, the examiner will select loans which, in his or her experience, will most probably have incorrectly disclosed APRs, if they exist. These will normally be loans which contain required deposit balances, prepaid finance charges, or on which credit life, accident, health, or disability insurance is offered.

(2) The review of each of these judgmentally selected loans will include only verification of the APR. (This includes verification that proper disclosures for credit insurance were given.) If no reimbursable violations are found, the FCU will not be required to conduct a file search and no restitution will be required as a result of this examination step.

(3) If a reimbursable violation is found in any of the jugmentally selected loans, the examiner will determine if a pattern and practice existed at the time the loans were consummated. As discussed in subsection c, an expanded sample (as provided in section CCE-16.6 need not be conducted to verify a pattern and practice, if such pattern and practice is apparent through this (or other) examination steps.

(4) If a pattern and practice does not exist, restitution will be required for the loan on which a reimbursable violation was detected. However, the officials will not be required to conduct a file search to review for other errors.

(5) If a pattern and practice is found to exist, the officials will be required to conduct an appropriate file search and restitution will be required for affected loans. As in other restitution cases, the examiner will make reasonable efforts to determine the cause of the violations in order to restrict the file search to the shortest period of time and fewest loans possible. For this examination step, the file search and restitution period will be from January 1, 1977 through March 31, 1980 (unless a more restricted time period can be determined by the examiner to be appropriate).

e. All loans reviewed pursuant to section CCE-16.2 will be profiled on NCUA 3028, Consumer Regulations Compliance Profile of Loans.

f. In calculating whether a TiL violation is reimbursable, the definitions (and tolerances) provided in definition No. 5 of section CCE-16.3 will be used. In calculating the amount of restitution, the provisions under the heading "Calculating the Adjustment" will be used. The other definitions and provisions of section 16.3 will also be used.

g. During any examination in which restitution is ordered, the examiner will discuss the following facts. Section 130 of the Truth in Lending Act provides protection from civil liability if the creditor takes certain actions. Reimbursement as required by the Truth in Lending Act and the Uniform

Enforcement Policy (section CCE-16.3) will not necessarily protect the FCU from civil liability. The officials will be referred to Section 130 for further information regarding civil liability protection. If the FCU officials wish to to adjust their restitution to provide civil liability protection, the examiner will contact the Chief of Consumer Affairs for guidance.

h. All telephone communications from examiners to Chiefs of Consumer Affairs regarding restitution requirements in FCUs and the resulting determination of whether restitution will be ordered, will be expedited by regional office staff. This will provide FCU officials the earliest possible notice and allow maximum time for corrective action.

16.3 ADMINISTRATIVE ENFORCEMENT OF THE TRUTH IN LENDING ACT - RESTITUTION

The Depository Institutions Deregulation and Monetary Control Act of 1980 (P.L. 96-221), was enacted on March 31, 1980. Title VI of that Act, the Truth in Lending Simplification and Reform Act, amends the Truth in Lending Act, 15 U.S.C. §§ 1601 et seq. Section 608 of Title VI, effective March 31, 1980, authorizes the Federal Truth in Lending enforcement agencies to order creditors to make monetary and other adjustments to the accounts of consumers in cases where an annual percentage rate or finance charge was inaccurately disclosed. It generally requires the agencies to order restitution when such disclosure errors resulted from a clear and consistent pattern or practice of violations, gross negligence, or a willful violation which was intended to mislead the person to whom the credit was extended. However, the Act does not preclude the agencies from ordering restitution for isolated disclosure errors.

This policy guide summarizes and explains the restitution provisions of the Truth in Lending Act, as amended. The material also explains corrective actions the financial regulatory agencies believe will be appropriate and generally intend to take in those situations in which the Act gives the agencies the authority to take equitable remedial action.

The agencies anticipate that most financial institutions will voluntarily comply with the restitution provisions of § 608 as part of the normal regulatory process. If a creditor does not voluntarily act to correct violations, the agencies will use their cease and desist authority to require correction pursuant to: 15 U.S.C. § 1607 and 12 U.S.C. § 1818(b) in the cases of the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency; 15 U.S.C. § 1607 and 12 U.S.C. §§ 1464(d)(2) and 1730(e) in the case of the Federal Home Loan Bank Board; and, 15 U.S.C. § 1607 and 12 U.S.C. § 1786(e)(1) in the case of the National Credit Union Administration.

RESTITUTION PROVISIONS

Definitions

Except as provided below, all definitions are those found in Truth in Lending Act ("Act") and Regulation Z, 12 CFR Part 226.

1. "Current Examination" means the most recent examination begun on or after March 31, 1980, in which compliance with Regulation Z was reviewed.

2. "Irregular Mortgage Transaction" means a loan secured by real estate for which the annual percentage rate (APR) cannot be calculated using Volume I of

the Federal Reserve System's Truth in Lending, Regulation Z, Annual Percentage Rate Tables.

3. "Lump Sum Method" means a method of reimbursement in which a cash payment equal to the total adjustment will be made to a consumer.

4. "Lump Sum/Payment Reduction Method" means a method of reimbursement in which the total adjustment to a consumer will be made in two stages:

a) a cash payment that fully adjusts the consumer's account up to the time of the cash payment; and,

b) a reduction of the remaining payment amounts on the loan.

5. "Understated APR" means:

a. For other than irregular mortgage transactions, a disclosed APR which, when increased by one-quarter of one percentage point, is less than the actual APR calculated under the Act, without taking into account the tolerance provided by section 107(c) of that Act.

b. For irregular mortgage transactions consummated before April 1, 1981, a disclosed APR which is less than the actual APR calculated under section 107(c) of the Act, including a one-half of one percentage point tolerance.

c. For irregular mortgage transactions consummated after March 31, 1981, but before April 1, 1982, a disclosed APR which, when increased by one-quarter of one percentage point (instead of one-half of one percentage point), is less than the actual APR calculated under the Act, without taking into account the tolerance provided by section 107(c) of that Act.

d. For all loans consummated after March 31, 1982 (including irregular mortgage transactions), which have an amortization schedule of 10 years or less, a disclosed APR which, when increased by one-quarter of one percentage point, is less than the actual APR calculated under the Act, without taking into account the tolerance provided by section 107(c) of the Act.

e. For all loans consummated after March 31, 1982 (including irregular mortgage transactions), which have an amortization schedule of more than 10 years, a disclosed APR which is less than the actual APR, including the tolerance contained in section 107(c).

f. For all loans determined to contain a willful violation intended to mislead a consumer, a disclosed APR which is less than the actual APR including the tolerance contained in section 107(c).

6. "Understated Finance Charge" means a disclosed finance charge which, when increased by a numerical tolerance that is generated by the corresponding APR tolerance,* is less than the finance charge calculated under the Act.

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*Finance charge tolerance: the finance charge tolerance for each loan will be generated by the corresponding APR tolerance applicable to that loan. For example, consider a single-payment loan with a one-year maturity which is subject to a one-quarter of one percent APR tolerance. If the amount financed is $5,000 and the finance charge is $912.50, the APR will be 18.25%. The finance charge generated by the APR of 18% on that loan would be $900. The difference between $912.50 and $900 produces a numerical finance charge tolerance of $12.50. If the disclosed finance charge is not understated by more than $12.50, reimbursement would not be ordered.

De Minimis Rule

If the amount of adjustment on an account is less than $1.00, no restitution will be ordered. However, the agencies may require a creditor to make any adjustments of less than $1.00 by paying into the United States Treasury, if more than one year has elapsed since the date of the violation.

Corrective Action Period

1. Open-end credit transactions will be subject to an adjustment if the violation occurred within the two-year period preceding the date of the current examination.

2. Closed-end credit transactions will be subject to an adjustment if the violation resulted from a clear and consistent pattern or practice or gross negligence where:

   a. There is an understated APR on a loan which originated between January 1, 1977 and March 31, 1980.

   b. There is an understated APR or understated finance charge, and the practice giving rise to the violation is identified during a current examination. Loans containing the violation which were consummated since the date of the immediately preceding examination are subject to an adjustment.

   c. There is an understated APR or finance charge, the practice giving rise to the violation was identified during the prior examination, and the practice is not corrected by the date of the current examination.

Loans containing the violation which were consummated since the creditor was first notified in writing of the violation are subject to an adjustment. [Prior examinations include any examinations conducted since July 1, 1969.]

3. Each closed-end credit transaction containing a willful violation intended to mislead the consumer consummated since July 1, 1969 is subject to an adjustment.

4. For terminated loans subject to 2 above, an adjustment will not be ordered if the violation occurred in a transaction consummated more than two years prior to the date of the current examination.

Calculating the Adjustment

Consumers will not be required to pay any amount in excess of the finance charge or dollar equivalent of the APR actually disclosed on transactions involving:

1. Understated APR violations on transactions consummated between January 1, 1977 and March 31, 1980, or
2. Willful violations which were intended to mislead the consumer.

On all other transactions, applicable tolerances provided in the definitions of understated APR and understated finance charge may be applied in calculating the amount of adjusment to the consumer's account.

Methods of Adjustment

The consumer's account will be adjusted using the lump sum method or the lump sum/payment reduction method, at the discretion of the creditor.

Violation Involving the Non-Disclosure of the APR or Finance Charge

1. In cases where an APR was required to be disclosed but was not, the disclosed APR shall be considered to be the contract rate, if disclosed on the note or the Truth in Lending disclosure statement.

2. In cases where an APR was required to be disclosed but was not, and no contract rate was disclosed, consumers will not be required to pay an amount greater than the actual APR reduced by one-quarter of one percentage point, in the case of first lien mortgage transactions, and by one percentage point in all other transactions.

3. In cases where a finance charge was not disclosed, no adjustment will be ordered.

Violations Involving the Improper Disclosure of Credit Life, Accident, Health, or Loss of Income Insurance

1. Through March 31, 1982:

   a. If the creditor has not disclosed to the consumer in writing that credit life, accident, health, or loss of income insurance is optional, the insurance shall be treated as having been required and improperly excluded from the finance charge. An adjustment will be ordered if it results in an understated APR or understated finance charge. The insurance will remain in effect for the remainder of its term.

b. If the creditor has disclosed to the consumer in writing that credit life, accident, health, or loss of income insurance is optional, but there is either no signed insurance option or no disclosure of the cost of the insurance, the creditor shall, unless a claim was made on the insurance policy and paid, be required to send a written notice to the affected consumer that the insurance is optional and may be cancelled within 45 days to obtain a full refund of all premiums charged. If the creditor receives no response from the consumer within 45 days, the insurance will remain in effect and no further corrective action, with respect to that loan, will be required.

2. After March 31, 1982, the above violations of section 106(b) of the Act will be treated as APR or finance charge violations for adjustment purposes, as applicable.

Special Disclosures

Adjustments will not be required for violations involving the disclosures required by sections 106(c) and (d) of the Act.

Obvious Errors

If an APR was disclosed correctly, but the finance charge required to be disclosed was understated, or if the finance charge was disclosed correctly but the APR required to be disclosed was understated, no adjustment will be required if the error involved a disclosed value which was 10 percent or less of the amount that should have been disclosed.

Agency Discretion

Adjustments will not be required if the agency determines that the disclosure error resulted from any unique circumstance involving a clearly technical and non-substantive disclosure violation which did not adversely affect information provided to the consumer and which did not mislead or otherwise deceive the consumer.

Safety and Soundness

In connection with loans consummated before April 1, 1980, if full adjustments would have a significantly adverse impact upon the safety and soundness of the creditor, partial adjustments which do not have such an impact may be required. In connection with loans consummated after March 31, 1980, full adjustments will always be required. However, the affected creditor will be permitted to make the full adjustment in partial payments over an extended period in order to minimize the adverse impact on its safety and soundness.

Exemption from Restitution Orders

A creditor will not be subject to an order to make an adjustment if within 60 days after discovering a disclosure error, whether pursuant to a final written examination report or through the creditor's own procedures, the creditor notifies the person concerned of the error and adjusts the account to ensure that such person will not be required to pay a finance charge in excess of the finance charge actually disclosed or the dollar equivalent of the APR disclosed, whichever is lower. This 60-day period for correction of disclosure errors is unrelated to the provisions of § 130, Civil Liability, of the Truth in

Lending Act.

16.4 "GOOD FAITH" DEFENSE

Section 226.5(c)(3) of Regulation Z provides an FCU with a defense if an error is made in the disclosure of the annual percentage rate and/or amount of finance charge due to the good faith use of an inaccurate chart, table, computer or calculator. "Good faith" reliance requires the creditor to have verified the disclosure results obtained from the calculation tool. This could be done by comparing the results to known accurate results or by sending the tool to NCUA for verification. The credit union is required to promptly discontinue use of the calculation aid _and_ to notify the Federal Reserve Board or a Federal Reserve Bank in writing of the error in order to gain the full benefit of the defense by protecting itself from future lawsuits. The credit union must identify the calculation aid by its identification number and identify the name and address of the person (or company) responsible for production. Errors in software developed in-house would also be covered provided they are _bona fide_ errors that occurred despite the application of generally accepted programming controls. An absence of adequate programming controls will be considered a breach of _good faith_ since the credit union has the ability to police its own operations. NCUA will not require reimbursement (section 16.4) for errors made due to _good faith_ use of inaccurate charts, tables, calculators, or computer equipment. However, the examiner will not accept a claimed good faith defense by the FCU prior to consulting with the Chief, Consumer Affairs. If the credit union's good faith defense is accepted, the examiner will have the credit union notify the Federal Reserve Board and the supplier of the chart, table, calculator or computer equipment. The written notices will be mailed prior to the conclusion of the examination and copies will be included in the notes section of the examination report.

16.5 HANDLING NON-REIMBURSABLE VIOLATIONS

In most FCUs, the majority of violations will relate to noncompliance of preprinted forms and/or completion of the forms. These, and some other violations, are not reimbursable under the provisions of the Section 108(e) of the TiL Act (refer to section 16.4). Although not reimbursable, these violations are serious. Any violation of Regulation Z, except violations of Section 226.10, subjects the FCU to potential civil liability. Additionally, non-reimbursable violations may be subject to other NCUA enforcement procedures.

The non-reimbursable violation(s) will be thoroughly discussed with the appropriate FCU officials and employees. The examiner will clearly explain the nature of the violation(s) in an understandable manner. The examiner must also be prepared to offer reasonable suggestions on ways of correcting the noted violations. To the extent possible, the examiner will seek corrective action on the violations before conclusion of the examination. The violations will be reflected on NCUA 3013, Loan Review Results and NCUA 3323, Consumer Regulations Compliance Checklist. For all repetitive and/or serious violations, the plan for corrective action will be reported in the Record of Action.

16.6 HANDLING REIMBURSABLE VIOLATIONS

The Financial Institution Deregulation and Monetary Control Act of 1980 became law on March 31, 1980. Title VI of this Act is the TiL Simplification and Reform Act. Section 608 of this title amended Section 108 of the TiL Act by adding subsection (e). The new section 108(e) of the TiL Act (known as "Restitution") became effective March 31, 1980.

Section 108(e) charges all Federal financial institution regulators to require restitution (reimbursement) to consumers for certain violations of the TiL Act. The FFIEC (Federal Financial Institution Examination Council, which is composed of the FRB, FDIC, FHLBB, NCUA and OCC) has adopted a uniform implementation and enforcement policy to enforce Section 108(e). This policy is discussed in sections 16.2 and 16.3. In general, the enforcement policy provides for reimbursement to the member for underdisclosures due to improper disclosure of the Annual Percentage Rate, Finance Charge, and Credit Life, Accident, Health or Loss of Income Insurance.

If the review and verification of loans reviewed according to section 15 reveal no violations which require reimbursement, no additional review is necessary. The FCU will be considered in compliance with those areas of the TiL Act and Regulation Z which require reimbursement.

If a violation requiring reimbursement is discovered regarding any loan reviewed according to section 15, the examiner must determine if there is a pattern and practice of the noted violation. A pattern and practice is present where there is more than one reimbursable violation of the same type (except in very rare cases). For example, a pattern and practice for a prepaid finance charge violation could be "all real estate loans made at XYZ branch office after a certain date." If a pattern and practice is present, the reimbursable violation is not due to an isolated, non-recurring clerical error.

If a pattern and practice of reimbursable violations is not clearly established from the systematic random and selected sample loan reviews, the examiner will perform an expanded sample loan review. The expanded sample loan review will be conducted in the following step-by-step order:

After defining the pattern and practice, the reimbursable violation(s) will be promptly discussed with the treasurer, manager, and other appropriate officials to confirm the scope of the problem and the probability of agreement to reimbursement. The following areas, plus any additional areas the examiner feel are important, will be discussed:

a. Type(s) of violation(s) which may cause reimbursement.

b. Example(s) of loan(s) which may require reimbursement.

c. Effect of reimbursement on FCU, e.g., review of loans by FCU, potential cost of reimbursement to FCU based on consumer examiner's prior experience with reimbursement situations, adverse reactions by members, etc.

At this point, the FCU official(s) and key employee(s) may offer various rebuttals to the violation(s) determined by the examiner. Common rebuttals which may be expressed are as follows: "the last examiner told us to do it this way", "the league told us to do it this way", etc. However, unless these allegations can be documented or otherwise supported by the FCU, the rebuttal will not be considered by NCUA. Rebuttals which will be reviewed by the consumer examiner are: (a) NCUA correspondence to the FCU regarding the disclosure requirement, and (b) Federal Reserve Board correspondence. The existence of such correspondence does not assure the FCU that reimbursement will not be required. However, the written documentation will be considered by the regional director in determining whether to require reimbursement; and if required, in determining the time period affected by the reimbursement. If reimbursement is deemed necessary, the regional director may consult with OCA where the FCU officials have provided written documentation supporting their rebuttal.

At this point, the examiner will promptly communicate all relevant facts to the Chief of Consumer Affairs. (The Chief will also be notified prior to requiring an individual reimbursement.) The examiner will be prepared to discuss: (a) the reimbursable violation(s) noted, (b) estimate of the dollar amount of reimbursement, (c) financial impact on the FCU, (d) ability of FCU officials and employees to handle reimbursement, (e) impact and existence of surety coverage, (f) probability of FCU officials agreeing to reimbursement, and (g) any other problems anticipated in affecting reimbursement. The Chief of Consumer Affairs will: (a) confirm the need for reimbursement, and (b) provide appropriate guidance.

When a pattern and practice of reimbursable violations is detected by the examiner and confirmed by the regional director, a joint conference will be scheduled. A quorum of the board of directors will be present, if possible. Additionally, representatives of the supervisory committee and, if appropriate, the credit committee will be urged to attend. Scheduling the time and date of the joint conference will be completed as soon as possible to provide officials time to make necessary arrangements. If the joint conference cannot be held, the examiner will contact the Chief of Consumer Affairs for guidance. At the joint conference, the examiner will discuss the following:

a. Type(s) of violation(s) requiring reimbursement;

b. Loans to be reviewed by the FCU;

c. Training and equipment needs of the FCU;

d. Pros and cons on the different methods (lump sum or lump sum/payment reduction) of reimbursement (Remember that the method to be used is at the FCU's option.);

e. Pros and cons on the different manners (cash, check, or deposit to member's share account) of reimbursement (Remember that the manner chosen is at the FCU's option; and if reimbursement is made by deposit to shares, withdrawal of shares so credited may not be restricted by the FCU.);

f. Time needed to complete reimbursement;

g. Anticipated problems in effecting reimbursement;

h. Surety coverage;

i. Possible public relations problems;

j. FCU reporting requirements; and

k. Necessary prospective corrective action(s).

If the officials wish to delay decision until their attorney or surety has reviewed the situation, a reasonable period of time will be allowed. Normally this will not exceed 4 - 6 weeks. Appropriate follow-up will be designed in such cases. If the officials do not agree to the reimbursement, the examiner will recommend the appropriate administrative action in accordance with section AA. The administrative action will normally be a preliminary warning letter for a cease and desist order.

If the officials agree to the reimbursement, the examiner will provide the officials with a copy of the NCUA booklet entitled, "Regulation Z Reimbursement Procedures and Instructions." The examiner will provide the necessary training and guidance to the persons responsible for calculating and making the reimbursement in accordance with NCUA's reimbursement booklet. Where possible, the reimbursement will be started during the examination Also, during the examination, the examiner will have the FCU notify the surety of potential bond claims arising from the reimbursement. The notification to surety should take place prior to the FCU instituting reimbursement. Generally, if the credit union has coverage for Reg Z violations, the bond requires that surety be allowed to confirm that restitution is necessary.

It is important for the examiner to document in the examination report all pertinent information concerning the reimbursement. The reimbursement will be documented in the examination report as follows:

a. Problem code (7) will be assigned and a Consumer Compliance Record of Action will be prepared. In addition to the requirements discussed in sections

2 and 30, the ROA will address each of the following:

(1) Type(s) of violation(s) discovered which require reimbursement;

(2) Loans to be reviewed by the FCU for reimbursement determination (Include *effective date* and loan type for loans to be reviewed, *e.g.*, all refinanced loans granted since July 1, 1975.);

(3) Method of reimbursement to be used, *i.e.*, lump sum or lump sum/payment reduction;

(4) Manner of reimbursement to be used, *i.e.*, cash/check payment to member, credit to member's share account (withdrawal of shares so credited may not be restricted by the FCU), and/or credit to outstanding loan balance of a delinquent loan to bring the loan current with any excess being reimbursed to the member;

(5) FCU reporting requirements (FCU will be required to notify the district consumer examiner if the completion dates cannot be met for any reason.); and

(6) Prospective corrective action(s) for the reimbursable violations.

b. Copies of all loan forms (note, application, TIL disclosure, collateral documents, etc.) for each examiner-reviewed loan requiring reimbursement will be included in the examination report. If copying the loan forms is not feasible, the examiner will transcribe the loan information onto blank loan forms used by the FCU. These forms will be placed in the envelope provided for that purpose. This envelope will be included in the examination report immediately following NCUA 3028, Profile of Loans.

16.7 FOLLOW UP AFTER REIMBURSEMENT

The examiner will consider the necessity of making an on-site, follow-up examination within ten working days after the reimbursement completion date established by the ROA. In making this decision, consideration should be given to the following: (a) financial impact of the reimbursement; (b) ability of the FCU officials and/or employees to handle the reimbursement; (c) other problem areas noted during the examination; and (d) past experience with the officials in maintaining agreements reached during examinations. As a general rule, an on-site, follow-up examination will not be necessary prior to the next regularly scheduled examination. In such cases, the verification of the reimbursement will be made during the consumer compliance examination in accordance with the general instructions outlined in part S, Supervision. The information required by part S may be reflected in either a memo or the Closed Section. In the interim period between examinations, the reimbursement will be monitored by telephone contact(s) and the report (NCUA 3306) submitted by the FCU in accordance with established regional office procedures. An on-site, follow-up examination will be mandatory if administrative action is being recommended. If an on-site examination is deemed necessary or mandatory, it will be made in accordance with the procedures outlined in part S.

16.8 REVISED REGULATION Z

a. General

On March 31, 1980, the Depository Institutions Deregulation and Monetary Control Act of 1980 was signed into law. Title VI of this act is the Truth in Lending Simplification and Reform Act.

The Simplification Act required the Federal Reserve Board (FRB) to revise Regulation Z to implement the provisions of the Simplification Act. The Truth in Lending Simplification and Reform Act of 1980 did not totally replace the Truth in Lending Act of 1968. It merely amended the act in numerous substantive ways. The FRB, however, decided to totally rewrite Regulation Z. The Simplification Act required Regulation Z to be amended (or rewritten) by April 1, 1981. While the Simplification Act does not become fully effective until April 1, 1982, Congress wanted creditors to have at least one year to begin converting to and complying with the revised Regulation Z before it becomes mandatory.

In May, 1980, the FRB issued the first proposed revised Regulation Z for public comment. After receiving and reviewing responses from some 500 commentors, the FRB issued a revised proposed revision to the regulation in December, 1980. After receiving and reviewing the again numerous comments, the FRB issued the final revised Regulation Z on March 26, 1981.

According to the FRB press release accompanying the revised regulation, the primary objectives in revising and simplifying Regulation Z were:

- To reduce substantially the burden of compliance;
- To assist small creditors by streamlining regulatory requirements;
- To assist the majority of consumers by focusing the regulation on material disclosures and the dominant objectives of the law; and
- To make the revised and simplified regulation a model of rational regulation under consumer credit protection laws.

b. Compliance Dates

Credit unions may begin to comply with the revised Regulation Z on loans consummated on or after April 1, 1981. Compliance with the revised regulation is mandatory for all loans consummated on or after April 1, 1982.

c. Transition Rules

During the period April 1, 1981 through March 31, 1982, credit unions may "convert" to the new Regulation Z. A credit union may wish to convert its entire operation to the new requirements at one time or it may prefer to phase in the new requirements over a period of time.

Piecemeal conversion is permitted in almost any manner which a credit union may desire. The credit union could convert to the new rules by loan category, e.g., real estate loans, open end credit, closed end credit, unsecured loans, etc. The credit union may wish to convert branch by branch as the employees at each branch are trained in the requirements of the new regulation. The credit union may even convert on a loan by loan basis.

The credit union may not, however, "mix and match" requirements from the old regulation and the revised regulation for a single loan transaction. For example, a credit union could not grant a loan using a combined note and disclosure (as permitted under the old regulation) and refuse to disclose the required deposit balance because a 5% dividend is paid on shares (as permitted under the revised regulation). This would be mixing the requirements of the old and the revised regulations for a single transaction. All disclosures for a single transaction must be made in accordance with either the old regulation or the revised regulation. Additionally, a credit union may not take advantage of the new tolerances (e.g., the finance charge tolerance) unless it makes disclosures based on the requirements of the revised regulation.

A credit union may do the following even though it has not converted its operations to the revised regulation:

- Follow the credit advertising rules of the revised regulation.
- Follow the right of rescission rules of the revised regulation.
- Rely on the revised regulation's definitions to determine whether the creditor or a particular transaction is covered.

The existing FRB staff position letters, both official and unofficial, continue to apply to old Regulation Z. These letters do not apply to the revised regulation. The FRB will issue and maintain a "commentary" as the only official staff interpretation of the revised regulation. Those letters which the FRB determines are applicable to the revised regulation will be incorporated into the commentary.

d. Changes in the Regulation

The revision to Regulation Z changed a great many of the requirements of the regulation. Following is a listing of some of the more important changes which affect credit unions. This listing is not all inclusive nor intended as a substitute for the regulation nor the discussion in the Manual of Laws.

(1) The term "consummation" is now defined as the time when a contractual relationship is created under state law between the member and the credit union.

(2) Disclosures must be based on the "legal obligation". This means that disclosures are based on the terms of the note/contract. If the member agrees to repay by weekly payroll deduction where the note calls for monthly payments, disclosures are based on monthly payments, not weekly.

(3) The term "refinancing" has been redefined to cover only those situations where the old note is completely replaced by a new contract. Few if any credit union extension agreements meet this revised definition. Thus, few extension agreements would require new disclosures.

(4) For open end credit, "annual percentage rate" and "finance charge" are the only two required terms.

(5) The minimum periodic payment is no longer required to be disclosed for open end credit transactions.

(6) A finance charge tolerance of $5 for loans of $1000 or less and $10 for loans greater than $1000 is provided. This tolerance is in addition to any tolerance provided for "minor irregularities", etc.

(7) "Required deposit balances" have been almost eliminated as far as credit unions are concerned. Even where an RDB exists, it does not have to be considered in calculating the APR.

(8) Specific disclosures for variable rate loans are required.

(9) Closed end disclosures must be segregated from all other information (contract terms, security agreement provisions, etc.).

(10) Itemization of the "amount financed" is not required unless requested by the member.

(11) Disclosure requirements for security interests have been substantially revised.

(12) Model disclosure forms and clauses have been provided. Protection from civil liability is provided if these forms and clauses are used properly.

e. Consumer Compliance Examination Procedures

Prior to beginning the review of advertising (CCE-11), form review (CCE-14), or review of loans (CCE-15), the examiner will determine the date or dates on which the FCU converted to the revised Regulation Z. As noted in section 16.8.c., the FCU may have converted its procedures for different loans at different times.

The examiner should be able to determine the effective date(s) of conversion during the review of board minutes (CCE-9) or during the review of lending policies (CCE-10). If these two examination steps do not provide the applicable dates of conversion, the appropriate officials/employees should be contacted. Discussions with these officials/employees should enable the examiner to determine at least the approximate date of conversion. It is important to remember that loans consummated prior to April 1, 1981 must comply with the old Regulation Z; loans consummated from April 1, 1981 through March 31, 1982 may comply with either regulation; and loans consummated on or after April 1, 1982 must comply with the revised Regulation Z.

It is possible that an FCU may not have documented the date(s) of conversion. In this event, after discussions with appropriate officials/employees, it will be necessary for the FCU to demonstrate that it has attempted to comply with the revised regulation if the officials desire examination for compliance with the revised regulation. The officials could demonstrate their attempt to convert by producing revised forms, legal opinions, etc. Such evidence must then be considered by the examiner in determining which regulation will the basis for examination for which loans. If the examiner has any questions in this area, he or she should contact the Chief of Consumer Affairs immediately. After a decision is reached, the appropriate officials/employees will be informed of the decision. This, of course, will not be necessary when the examiner and officials agree beforehand regarding date(s) of conversion.

The examiner will document on NCUA 3006, Consumer Compliance Examination Information Worksheet, the date(s) of conversion to revised Regulation Z. This information will be recorded in the section of NCUA 3006 headed, "Equipment used to calculate Truth in Lending (Regulation Z) disclosure information:".

f. Handling Violations

The guidance provided in sections CCE-16.5 and 16.6 will be followed when reviewing loans and procedures for compliance with revised Regulation Z. In addition, the following guidelines will be followed:

(1) During all discussions with official/employees regarding Regulation Z, care will be taken to ensure that the officials/employees clearly understand which Regulation Z is being discussed.

(2) All Regulation Z citations on NCUA 3009, Record of Action; NCUA 3010, Supplementary Comments and Recommendations; NCUA 3012, Consumer Examiner's Findings; and NCUA 3013, Loan Review Results will clearly indicate "revised Reg. Z" when the exception applies to the new regulation. Exceptions to the old regulation may continue to be cited as violations of "Regulation Z."

(3) Questions on NCUA 3323, Consumer Regulations Compliance Checklist, will be answered as applicable depending on whether the FCU is attempting to comply with the old or the revised regulation. The Reg. Z section citations on the 3323 will be ignored when recording compliance with the revised Regulation Z. For example, Question #16 regards record retention and cites Section 226.6(i). If the FCU is attempting to comply with the revised Regulation Z, the appropriate citation would be 226.25(a). Nevertheless, failure to comply with either 226.6(i) of the old regulation or 226.25(a) of the revised regulation would require #16 to be answered "NO".

ELECTRONIC FUND TRANSFER ACT (REGULATION E)

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ELECTRONIC FUND TRANSFER ACT (REGULATION E)

17. GENERAL

The Electronic Fund Transfer Act (EFTA) (15 USC 1693) was enacted on November 10, 1978, and became effective May 10, 1980. The EFTA is implemented by Federal Reserve Board Regulation E (12CFR 205). Two sections of the Act became effective February 8, 1979. The other sections became effective May 10, 1980. EFTA provides a basic framework establishing the rights, liabilities and responsibilities of participants in electronic funds transfer systems. The most important consumer rights are the limited liability for unauthorized use of the access device, the right to receive certain disclosures, the right to stop payments, and the right to dispute errors. The Act has civil and criminal liabilities for violations of its provisions. The Act designates NCUA as the enforcement agency for Federally chartered credit unions.

17.1 EXAMPLES OF EFTs

As defined in the Act, an electronic fund transfer (EFT) refers to a transaction initiated through an electronic terminal, telephone, or computer that instructs a financial institution to either credit or debit an asset account. Examples of electronic fund transfer services are automated teller machines, telephone bill payment service, point of sale terminals in stores, and preauthorized transfers from or to a consumer's account. Some payroll deductions are EFTs.

17.2 "GOOD FAITH" DEFENSE

A credit union is liable in a civil suit to the consumer for all damages:

a. Caused by the credit union failing to honor an EFT when properly instructed to do so.

b. When it fails to honor an EFT because of failure to credit to a consumer's account a deposit that would have provided sufficient funds to make the transfer; and

c. For failure to stop payment when properly requested to do so.

The credit union is not liable, however, if it can show that the failure was caused by an act of God or other circumstances beyond its control and it exercised reasonable care to prevent the occurrence, or it was caused by a technical malfunction that was known to the consumer at the time he or she attempted to initiate the transaction, or in case of a bona fide error, provided the credit union can show it maintained procedures reasonably calculated to avoid such errors. The examiner should caution the credit union that the circumstances beyond control and the bona fide error defenses are similar to those defenses in Truth in Lending in that the credit union must be able to show that it maintained procedures reasonably calculated to avoid the error or that it exercised reasonable care. All credit unions should therefore maintain internal control procedures to ensure that the system is operating properly and that the requirements of the regulation are being fulfilled.

17.3 CONSUMER COMPLIANCE EXAMINATION PROCEDURES

The examiner will determine compliance with Regulation E by following the examination procedures approved by the Federal Financial Institutions Examination Council (FFIEC) and adopted by NCUA. These examination procedures include an 8-page checklist (NCUA 3322) which relates directly to NCUA 3323, Consumer Regulations Compliance Checklist. The examiner will answer only those checklist questions which are applicable to the credit union. The answers to the applicable questions and compliance with Regulation E will be determined while performing the following examination steps regarding EFT transactions:

a. Review overdraft privileges that may be accessible through use of an access device. (section CCE-16).

b. Review the following:

(1) disclosure forms, machine receipts, and descriptive periodic statements (section CCE-14);

(2) any third party, merchant, or account agreements (sections CCE-9 and CCE-14);

(3) procedural manuals and written policies (section CCE-9);

(4) complaint handling procedures (section CCE-1.4); and

(5) advertising (section CCE-11).

c. Test for compliance with error resolution procedures and identify any apparent deficiencies in the credit union's operations.

d. Test for adherence to written policies and internal controls identifying any apparent differences between policies and practices.

During each examination, the examiner will answer question #1 in the Regulation E section of NCUA 3323. If the answer is "NO", no further action need be taken. If the answer is "YES", the examiner will complete NCUA 3322, and the remainder of the Regulation E section of NCUA 3323.

The examiner will complete the 8-page FFIEC checklist (NCUA 3322) which is divided in 10 sections. The first section is 205.5 and the last is Internal Control Procedures. The first nine of these sections relate directly to questions 2 - 10 of the Regulation E portion of NCUA 3323. For example, the first section of questions in the FFIEC checklist (205.5) relates to question #2 of our checklist, NCUA 3323. Each question in Section 205.5 of the FFIEC checklist will be answered. If the answer to any question (or part of a question) is "NO", question #2 on NCUA 3323 will be answered "NO". For example, if the FCU issues validated, unsolicited access devices, the answer to question #2.a. of the FFIEC checklist would be "NO". This answer (as would any other "NO" answer) would require question #2 on NCUA 3323 to be answered "NO". If all questions in Section 205.5 are answered "YES", question #2 on NCUA 3323 will be answered "YES". The same procedures apply to FFIEC checklist Sections 205.6, 205.7, etc. The one exception is the last section of the FFIEC checklist, Internal Control Procedures.

The examiner will complete the Internal Control section of the checklist and consider the results indicative of the overall effectiveness of the credit union's operating proceudres; a "NO" response does not necessarily indicate a violation of law. While discussing internal control procedures with the credit union officials, the examiner should remind the officials of the "Good Faith" defense involving bona fide errors discussed in section CCE-17.2, "GOOD FAITH" DEFENSE. A credit union that can show it maintained procedures reasonably calculated to avoid errors may not be held liable for all damages in a civil suit. Therefore, during each examination the examiner will discuss with the credit union officials those areas which require sound internal control procedures, the benefits of implementing such procedures, and which procedures require constant monitoring.

Further guidance for evaluating the credit union's internal controls:

a. An example of an area that requires constant monitoring relates to questions #1 and #8 on the FFIEC checklist. These two questions relate to error resolution procedures.

The requirements for compliance with Regulation E involve seven time periods starting at the time a member notifies a credit union of an unauthorized EFT. It is important that each person in the credit union be aware of the appropriate procedure in the event a member should notify the credit union of an error. From that point the credit union should maintain a log that tracks the error investigation. This type of procedure assures that compliance with error resolution requirements is accomplished in a timely manner as required by the regulation.

The following basic error resolution procedures can be recommended to officials: (1) log in all alleged errors; (2) investigate those errors and log results of investigation; and (3) promptly notify consumers of the result of the investigation. All three of these steps must meet the time constraints required by the regulation.

b. Question #2 assesses management's attitude toward resolving EFT complaints. A point that can be stressed with credit union officials is the credit union's potential liability when they have not implemented well-defined error resolution procedures.

c. Question #3 in this section can be answered by referring to Section 205.9 of the FFIEC checklist pertaining to Documentation of Transfers.

d. Question #4 may also be answered by referring to Section 205.9 of the FFIEC checklist.

e. The answer to question #5 regarding advertising of EFT services may be hard to determine. The general thrust of this question is to determine if the credit union actually provides the EFT services, etc. per the terms stated in their advertisements.

f. Question #6 relates to personal identification codes. If the credit union has implemented sound procedures for assigning access codes and informs the members of their responsibility while using the codes, this could effectively eliminate some unauthorized use of access devices. In turn, this could reduce the possibility of triggering error resolution procedures.

g. Question #7 is self-explanatory.

h. Finally, the answer to question #9 will be determined at the completion of the EFT section of the examination. Conversations with credit union personnel should be useful in appraising officials' ability to distinguish between the applicability of Regulations E and Z.

17.4 HANDLING EXCEPTIONS/VIOLATIONS

All exceptions are to be detailed on NCUA 3012, Consumer Examiner's Findings and on NCUA 3323, Consumer Regulations Compliance Checklist. All areas of exceptions will be discussed with appropriate officials and employees and corrective action agreed upon. Where possible the corrective action should be implemented during the examination. For repetitive and/or serious violations, the appropriate corrective action will be reflected in the Record of Action.

The Internal Control Procedures section of the FFIEC checklist does not relate to NCUA 3323. "NO" answers to the questions in this section do not necessarily indicate violations of Regulation E provisions. Efforts in this area should be aimed at detecting procedural weaknesses. Any recommendations regarding this area will be discussed with the appropriate officials/employees during the examination and recorded on NCUA 3010, Supplementary Comments and Recommendations.

FAIR CREDIT REPORTING ACT

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18. GENERAL

The Fair Credit Reporting Act (FCRA), which is part of the Consumer Credit Protection Act, became effective on April 25, 1971. The purpose of the Act is to require consumer reporting agencies to adopt reasonable procedures for meeting the needs of those in the fields of consumer credit, personnel, and insurance, and for credit reporting information on individuals in a manner which is fair and equitable to the consumer. The Act prescribes the use of such information with regard to confidentiality, accuracy, and propriety. Federal credit unions are affected by the Fair Credit Reporting Act as granters of credit and users of credit reports. They are also affected if they pass on to a third party information (other than their own credit experience) concerning a member. NCUA has been designated to enforce compliance with the Act with respect to Federal credit unions.

18.1 CONSUMER COMPLIANCE EXAMINATION PROCEDURES

The examiner will first need to determine if the credit union is a user of credit reports and/or information from an outside source. This will usually be done through discussions with the credit union officials and key employees at the start of the examination. A credit union which uses a consumer/credit reporting agency or obtains credit information from other creditors is generally aware of the FCRA and its basic requirements. However, credit unions which only obtain information from the sponsoring organization are oftentimes unaware that the credit union is affected by the FCRA. Some credit union officials incorrectly view information from the sponsor as internal information instead of outside credit information.

The examiner will also need to determine if the credit union is functioning as a consumer reporting agency. This will occur when the credit union furnishes information about a member to other creditors, other than information on its own transactions or experiences. Although it may be doing so, the officials and employees will usually be unaware that the credit union is functioning as a consumer reporting agency and as such has certain responsibilities under the FCRA.

If it is determined that the credit union is affected by the Act, the consumer examiner must ascertain the degree of the credit union's compliance with the Act's requirements. This will mainly be accomplished by answering the related questions on NCUA 3323, Consumer Regulations Compliance Checklist. The answers to these questions will be obtained as follows: (a) through discussions with the appropriate credit union officials and key employees, (b) by observing any verbal credit reporting during the examination, and (c) during the review of approved loans and rejected loan applications.

18.2 HANDLING EXCEPTIONS/VIOLATIONS

All noted exceptions will be discussed with the appropriate officials and key employees. The exceptions will be reflected on NCUA 3013, Loan Review Results and NCUA 3323, Consumer Regulations Compliance Checklist. Where possible, the necessary corrective action will be implemented and completed during the examination. If not, agreements for correction will be obtained from the appropriate officials and key employees. For repetitive and/or serious exceptions, the plans for corrective action will be reflected in the Record of Action.

HOLDER IN DUE COURSE

(PRESERVATION OF CONSUMER CLAIMS AND DEFENSES)

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Appendix 12 FTC Statement of Enforcement Policy

HOLDER IN DUE COURSE

(PRESERVATION OF CONSUMER CLAIMS AND DEFENSES)

19. GENERAL

The Federal Trade Commission (FTC), pursuant to the Federal Trade Commission Act, issued a Trade Regulation Rule concerning the Preservation of Consumers' Claims and Defenses on November 14, 1975, with an effective date of May 14, 1976. This trade rule is commonly known as the "Holder in Due Course Rule". The Preservation of Consumer Claims and Defenses Trade Rule was implemented to assist consumers in effecting performance or repair or obtaining redress if performance or repair could not be effected.

In its present form, Holder in Due Course compliance responsibility is placed on the seller of goods and services. It is the seller's responsibility to determine if a "business arrangement" (as defined in Section 433.1(g) of the FTC Trade Rule) with a credit union exists. If so, the seller must notify the FCU of that fact and instruct the FCU to insert the appropriate "notice" into its loan contracts. Failure by the seller to notify the FCU constitutes a violation on the seller's part, but not on the part of the credit union. This failure subjects the seller to the FTC's Cease and Desist authority.

19.1 CONSUMER COMPLIANCE EXAMINATION PROCEDURES

a. General:

Compliance with Holder in Due Course will be determined through discussions with appropriate officials and employees, review of board and executive committee minutes, review of insurance and group purchasing activities, and by answering the related questions on NCUA 3323, Consumer Regulations Compliance Checklist.

b. FCU is the seller:

On occasion an FCU will sell and finance consumer goods to one or more of its members or non-members. This will normally occur when the FCU sells and finances repossessed or credit union owned property. Simply selling such property does not subject the FCU to Holder in Due Course. The FCU must also finance the purchase of the property for the consumer (or have a "business arrangement" with another lender to finance such sales, which would be a rare circumstance). In such cases the examiner will ensure that the appropriate "notice" required by Section 433.2 of the Trade Rule is placed in the note. Failure to place the required "notice" in the note will constitute a violation of Section 433.2 on the FCU's part, if the FCU is the seller and the creditor (or has a "business arrangement" with a creditor).

c. FCU is not the seller:

If the examiner determines that a seller is referring customers to the credit union on a continuing basis for financing or if the credit union is affiliated (as defined in the Rule) with a seller, the examiner will determine if the seller has requested the credit union to place the appropriate "notice" in the note or other lien instrument. If so, the examiner will ensure that the appropriate required "notice" is being placed in the note or lien instrument. If the board of directors has not agreed to comply with the seller's request, the examiner will advise the officials to either: (1) discontinue the relationship with the seller, or (2) obtain a written interpretation from the FTC that a referral or affiliation does not exist between the credit union and the seller. If the seller has not requested that the "notice" be placed in the note or other lien instrument, the examiner will discuss with the FCU officials and key employees the requirements of the Trade Rule and what action(s) must be taken in the event such a request is made by the seller.

d. Inclusion of the "NOTICE":

Inclusion of the "notice" in a credit union note places the credit union "in the shoes of the seller" by making the FCU subject to all claims and defenses which the consumer/member legally has against the seller. However, Holder in Due Course does not give the consumer/member the right to withhold payment unilaterally. The manner and procedure by which a buyer may assert claims and defenses against the credit union are governed by the terms of the contract and applicable state law. The credit union's actual liability is limited to the amount of the loan, interest, and other related costs paid by the member to the credit union. In those cases where the credit union is placing the "notice" in the note or lien instrument, the examiner will ensure that the credit union is aware of its liability and has taken the appropriate actions to protect itself from unnecessary losses resulting from exercise of the consumer/member's rights under the Trade Rule.

The examiner should pay special attention to inclusion of the "notice" in an open-end contract. The potentially far-reaching impacts of such a "notice" (depending on the mechanics of including the "notice") on all credit extended under the contract should be carefully discussed with the officials.

e. Section 721.2, NCUA Rules and Regulations:

Under Section 721.2 of the NCUA Rules and Regulations (Group Purchasing Activities), a credit union may only advise its members of the availability of plans for the purchase of goods or services. Any actions by the credit union which result in an "affiliation" relationship under Holder in Due Course will often be in violation of Section 721.2. For example, the credit union may distribute informational material of the seller, but the credit union may not (in its own publications or orally) explain any benefits or encourage participation in a group purchasing activity. This fact should be taken into consideration when reviewing such activities and exception should be taken where violations are found to exist.

19.2 HANDLING EXCEPTIONS/VIOLATIONS

All exceptions/violations will be discussed with the appropriate officials and key employees. The exceptions/violations will be documented on NCUA 3323, Consumer Regulations Compliance Checklist, and NCUA 3012, Consumer Examiner's Findings. Where possible, the necessary corrective agreements will be implemented during the examination. For all repetitive and/or major violations, the plans for corrective action will be documented in the Record of Action.

19.3 HOLDER II

At the time the FTC published its Trade Regulation Rule on Holder in Due Course, the Commission also published a proposed amendment for comment. This proposed amendment was commonly referred to as the "lender version" of the Trade Rule at that time. Recently, the FTC has begun steps to finalize and implement this amendment which is now commonly known as "Holder II". Basically, Holder II will extend responsibility for compliance with the present Holder in Due Course Rule to lenders as well as sellers. The new Rule will place responsibility on lenders (credit unions) to determine if a business arrangement exists. Lenders will be responsible for placing the appropriate "notice" in their notes or other lien instruments.

Holder II is expected to be in final form and implemented by the FTC during 1980. When it becomes final, this section of the Consumer Examiner's Guide will be updated to include new examination procedures as necessary.

DEBT COLLECTION

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DEBT COLLECTION

20. GENERAL

The extension of credit to members is one of the two general purposes for which a credit union is chartered. Federal credit union members have the responsibility to repay loans in accordance with the agreed-upon terms. Prompt repayment of loans helps the member establish and maintain a sound credit rating, and also makes loan funds available to other members.

Unfortunately, not all members repay loans as agreed. This is due to many reasons including the unwise use of credit, recent unemployment, illness, and in rare instances, unwillingness. In most cases, delinquent loans result from either unforeseen financial problems or unwise extensions of credit by other creditors or sometimes by the credit committee or loan officer.

Regardless of the reason for the loan delinquency, the board of directors is required to establish and properly supervise an effective loan collection program (FCU Bylaws, Article VII, Section 5(c)). The collection program must not only be effective but also must be in accordance with applicable laws and regulations and should treat members as fairly as possible under the prevailing circumstances. (The Fair Housing Act, Section 701.31 of NCUA Rules and Regulations, and Regulation B prohibit discrimination when attempting to collect a delinquent loan.)

The Fair Debt Collection Practices Act prohibits unfair debt collection practices by "debt collectors." The credit union movement's own Debt Collection

Code published by CUNA encourages credit unions as a means of industry self-regulation, to follow the principles of the Fair Debt Collection Practices Act, even though the credit unions are not usually covered by the Act.

NCUA has also recommended that FCUs voluntarily conform to the principles of the Fair Debt Collection Practices Act. The primary reason for this recommendation is to promote fair treatment of FCU members. Also, a legal argument can be made that the Fair Debt Collection Practices Act defines what industry standards are fair and reasonable, and thus any FCU that does not follow it could be in violation of the Federal Trade Commission Act or any similar state laws that prohibit "unfair practices."

The Fair Debt Collection Practices Act (which is part of the Consumer Credit Protection Act) was enacted on September 20, 1977 and became effective on March 20, 1978. The purpose of the Act is to prevent abusive, deceptive, and unfair debt collection practices by "debt collectors." This term, as defined in the Act, covers collection agencies primarily, but also includes some FCUs. NCUA is designated in the Act as the enforcing agency for Federal credit unions that fall within the definition of debt collector. An aggrieved party may file suit in U.S. district court for actual damages and up to $1,000 in punitive damages, as well as court costs and attorney's fees. A successful class action suit subjects the credit union to the lesser of $500,000 or 1 percent of its net worth, actual damages to each named plaintiff, and court costs and attorney's fees.

20.1 PROVISIONS OF THE ACT

The debt collection questions on NCUA 3027, Special Recommendations Checklist, give a summary of the main provisions of the Fair Debt Collection Practices Act. These questions are discussed below:

#9. Does the FCU use collection notices that can be read by third parties (such as post cards)? The member's privacy should be protected. The debt is a private contract matter between the member and the credit union. The FCU should not use invasion of privacy as a means to coerce the member to pay the debt. This applies to both collection notices to the member and to skip-tracing notices to other parties that reveal the member is delinquent on the loan. (Sections 804(4) and 808(7).)

#10. Does the FCU use collection notices that simulate court or legal documents? The FCU should not send the member a notice that looks like a court document to create the impression that the FCU has gone to court or has taken some other legal action that is has not.

#11. Does the FCU use collection notices that contain false or misleading statements? For example, the FCU should not send the member a message, in order to get him/her to contact the FCU, saying that the members has won a prize. (Sections 807 and 807(10).)

#12. Does the FCU threaten any action it cannot legally take? For example, the FCU should not threaten (verbally or in writing) to repossess the member's car if the FCU does not have a security interest in it. Similarly, the FCU should not threaten to withhold money from the member's pay check if this cannot be legally done. (Section 807(5).)

#13. Does the FCU threaten any action it does not actually intend to take? This would be considered a false statement. For example, the collector should not threaten to repossess the member's car unless the FCU normally repossesses cars in similar situations or unless the FCU actually intends to do so in this particular case. Similarly, the FCU should not threaten to sue a member unless the FCU normally files suits in similar situations or unless the FCU actually intends to do so in this particular case. In general, the FCU should not threaten an action unless it intends to carry out the threat. (Section 807(5).)

#14. Does the FCU call the members before 8 AM or after 9 PM? Calls before 8 AM or after 9PM (unless specifically authorized by the member) are considered to be unreasonable. For long distance calls, these refer to the time at the member's location. (Section 805(a)(1).)

#15. Does the FCU make unnecessarily repeated calls to the member? For example, the collector should not call the member several times in one day and ask for payment. Such calls could be considered harassment. (An exception might be if the member hangs up on the collector.) (Section 806(5).)

#16. Does the FCU call the member on the job if the member's employer prohibits personal calls at work? Many employers do not like their employees to use the phone for conversations that are not work-related. In general, once the member requests not to be contacted on the job for this reason, the collector should refrain from calling there, and should mark the file accordingly. (Section 805(a)(3).)

#17. Does the FCU contact the member's supervisor or personnel office for assistance in collecting the debt? This is considered to be an invasion of the member's privacy. An exception would be where the member's employer has a formal debt counseling program, such as that authorized under Civil Service or military regulations. The collector may, however, contact third parties for skip tracing information. In these cases, the collector should not reveal that the member is delinquent on a loan. (Section 805(b).)

#18. Does the FCU discuss the debt with any other third party? The collector should not discuss the debt with third parties such as co-workers or neighbors. The collector may, however, discuss the debt with the member's spouse or a parent or guardian (if the members is a minor). The collector may, of course, discuss the debt with anyone who is liable for it, such as a comaker. As discussed above, the collector may contact third parties for skip-tracing information. If the collector calls the member and he or she is not home, the collector may leave a message to return the call, but should not state the purpose of the call (except as allowed above). (Section 805(b).)

#19. Does the FCU continue to contact the member after being notified in writing that the member disputes the obligation? There are several reasons a member might dispute a debt. One would be for legitimate complaints against the FCU, such as for a Truth in Lending overcharge. Or there may be disputed collection or repossession charges. The member may consider a comaker to be responsible for the debt, such as in a divorce case. The member is often willing to take the case to court and let a judge determine the amount of the debt he or she owes. In these cases, if the member notifies the FCU in writing and asks the FCU to stop contacting him or her, the FCU should comply. An exception is that the FCU may notify the member that further action is contemplated. (Section 805(c).)

#20. Is there any other indication of harassment or unfair treatment? The collector should not use profanity, threaten bodily harm, threaten (falsely) to ruin the member's credit rating, misrepresent the true nature of the debt or the possible outcome if the debt is not paid, or use any other collection tactics that are designed to coerce or trick the member into paying. (Section 806.)

For more detailed guidance on the above, the Fair Debt Collection Practices Act and the FTC interpretation letters should be consulted.

20.2 CONSUMER COMPLIANCE EXAMINATION PROCEDURES

Since NCUA is recommending that all FCUs voluntarily follow the principles of the Fair Debt Collection Practices Act, the same examination procedures will be followed whether or not the FCU is covered by the Act.

The examiner will inquire whether the FCU Board has formally adopted the CUNA Debt Collection Code or resolved to voluntarily follow the principles of the Act. If they have, the examiner will inquire what the the officials have done to implement the decision. Does the FCU have a copy of the Code or the Act? Has the FCU trained its collection staff about the principles of the Act? If the FCU has written collection procedures, have they been updated to reflect the principles of the Act? (For example, in the section on skip tracing, a statement should be added telling the collector not to discuss the debt with third parties.) If the officials have not established such procedures, the examiner will recommend that they do so.

If the FCU officials indicate they have not adopted the Code nor resolved to follow the principles of the Act, the examiner will recommend that they do so and that they implement the decision.

The examiner will request a copy of the FCU's written collection procedures (if any) and any form collection letters and delinquency notices in use. These will be reviewed for non-conformance with NCUA recommendations.

The examiner will request a copy of any member complaint letters received by the FCU within the past year (or the last complaints, whichever is less). These will be reviewed for allegations of non-conformance with NCUA's recommendations (including harassment or unfair treatment). For any such allegations, the examiner will review the member's collection file and discuss the allegations with the appropriate officials and/or employees.

The examiner will review the collection files (including notations kept by the FCU collector) for any instances of non-conformance. The examiner will look in particular for any instances of unfulfilled threats (verbal or written) or repeated telephone calls.

After reviewing the delinquent loan files, the examiner will meet with the official or employee who is responsible for collections and discuss the debt collection questions on NCUA 3027, Special Recommendations Checklist. For each question, the examiner will inquire what the FCU's standard procedures are. Any instances of non-conformance detected during the review of loans, forms, and procedures will be discussed at this time. For any such instances, a "WO" answer will be checked on NCUA 3027. The examiner will recommend that the officials not use the particular practice.

20.3 HANDLING NON-CONFORMANCE

The examiner will treat non-conformance as a "questionable practice" and follow the procedures in section 5 of this Guide. The examiner will recommend that the FCU modify its procedures to voluntarily conform to the principles of the Fair Debt Collection Practices Act. In making these recommendations, the examiner will be sure to explain to the officials the reason for the provision in the Act. Any instances of non-conformance will be reflected on NCUA 3027, Special Recommendations Checklist. The recommendation will also be reflected on NCUA 3010, Supplementary Comments and Recommendations.

20.4 HANDLING VIOLATIONS

The examiner will determine if the FCU is covered by the Fair Debt

Collection Practices Act by answering the first two related questions on NCUA 3323, Consumer Regulations Compliance Checklist. An FCU is covered by the Act if it is acting as a "debt collector" as defined by Section 803(6) of the Act. This would be if: (1) the FCU regularly collects or attempts to collect debts owed to other credit unions under a reciprocal agreement (almost always written); or (2) the FCU uses a name other than its official name when collecting delinquent loans. If the FCU is covered by the Act, the requirements apply only to those debts that meet this definition (Section 803(6).) In addition, only loans for personal, family or household purposes are covered by the Act (Section 803(5)).

If the FCU is covered by the Act, the examiner will use the examination procedures discussed above to determine compliance with the Act, and to answer Question #3 on NCUA 3323: "Does the FCU comply with the provisions of the Fair Debt Collection Practices Act?"

The examiner will treat non-conformance as a violation, but only for those particular loans where the FCU is acting as a "debt collector", as defined by the Act. All violations will be discussed with the appropriate official(s) and key employee(s). The violation will be reflected on wither NCUA 3323, Consumer Regultions Compliance Checklist, and NCUA 3012, Consumer Examiner's Findings. Where possible, the necessary corrective action(s) should be implemented during the examination. For all repetitive and/or serious violations, the corrective agreements or recommendations will be reflected in the Record of Action.

20.5 REFERENCES/STUDY GUIDES

a. Federal Credit Union Bylaws - Article VII, Section 5(c)

b. Board of Directors Manual for Federal Credit Unions - Page 17 under "Delinquent Loan Committee and Pages 28 and 29 under "Loan Collection".

c. NCUA Rules and Regulations - Section 701.31

d. Regulation B (Equal Credit Opportunity Act) - Sections 202.2(z) and 202.4

e. Fair Debt Collection Practices Act

EQUAL CREDIT OPPORTUNITY ACT
(REGULATION B)

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Appendix 8 Selected FRB Letters

Appendix 9 Federal Reserve Press Release, 4-19-79

EQUAL CREDIT OPPORTUNITY ACT (REGULATION B)

21. GENERAL

The Equal Credit Opportunity Act (ECOA), which is part of the Consumer Credit Protection Act, became effective on October 28, 1975. ECOA and its implementing Regulation B prohibit discrimination in any aspect of a credit (loan) transaction on the basis of sex, marital status, race, color, religion, national origin, age (provided the applicant is old enough and otherwise has the legal authority to enter into a binding contract), receipt of public assistance income, and the good faith exercise of rights under the Consumer Credit Protection Act (which includes Truth-in-Lending, Fair Credit Reporting, Fair Credit Billing, Equal Credit Opportunity, Fair Debt Collection Practices, and the Electronic Fund Transfer Acts). The ECOA designates NCUA as the enforcing agency with respect to Federal credit unions. The ECOA also provides for severe civil and criminal penalties in cases of noncompliance.

21.1 CREDIT DISCRIMINATION

Essentially discrimination is treating people unequally. Prohibited discrimination is defined in Regulation B as treating one loan applicant or group of applicants less favorably than others on a prohibited basis. The prohibited basis refers to the nine specific areas of prohibited discrimination. A credit union cannot, of course, treat all loan applicants the same way. Any member whose loan request is denied has, in effect, been treated loan. However, any such differences in the treatment of members must not constitute discrimination on a prohibited basis, but instead must be based on generally accepted and valid factors of creditworthiness.

ECOA was enacted to prevent certain groups of people, such as racial minorities, women, and the elderly, from being discriminated against when attempting to obtain credit. This was because most credit discrimination, when present, was directed toward these groups of people. However, the examiner must remain aware that under ECOA, there are no specific "protected classes" of people. Prohibited discrimination, in any form, whether against whites or blacks, men or women, young or old is both undesirable and illegal.

Examining for prohibited credit discrimination is one of the more complex and demanding parts of the examination. It is also one of the most important. Discriminatory patterns and even individual instances of discrimination are hard to detect and even more difficult to prove. Rarely will the examiner encounter outright, blatant instances of discrimination. In most cases, the officials will be unaware that their actions have had a discriminatory effect upon some members. The officials will have enacted the discriminatory policies and/or practices out of an honest concern for the financial condition of the credit union. This is because most discriminatory acts are due to incorrect but long held "general assumptions" about certain segments of society.

21.2 EFFECTS TEST

Footnote 7 to Section 202.6(a) of Regulation B states that Congress intended for the "effects test" concept to be applicable to a creditor's determination of creditworthiness. The "effects test" concept refers to U. S. Supreme Court decisions in the employment field. This concept is that a policy which is not discriminatory on its face, may nevertheless be found to be discriminatory if it has the effect of discriminating on a prohibited basis. The court used a three part test to determine if a policy was discriminatory:

Test 1. Does the policy or criterion have the effect of discriminating on a prohibited basis?

E.g., Assume that a credit union has an unsecured loan limit of $1,000 to sponsor employees and $500 to immediate family members of sponsor employees. The examination revealed that a substantial majority of married sponsor employees are men. Therefore, the unsecured loan policy has a discriminatory effect on the married women in the FOM.

Test 2. Is there a valid reason (business need) for the policy to exist?

E.g., The board of directors established the lower unsecured loan limit for immediate family members due to past experience of high loan losses to members who are not employed by the sponsor. Thus, there appears to be a valid reason (buisness need) for the policy.

Test 3. Is there another policy, procedure or criterion which fulfills this business need but which has a less discriminatory effect than the contested policy?

E.g., The examination revealed that the credit committee was not evaluating the creditworthiness of loan applicants. Instead, the committee simply approved all loan requests that came within the board's lending policies. This worked well for sponsor employees who repaid loans by payroll deduction. It was also noted that the credit union's collection procedures consisted only of sending three form notices. Therefore, the contested unsecured loan policy could be rescinded and replaced with better procedures in the areas of loan evaluation and debt collection.

When reviewing loan policies and procedures for possible "effects test" violations, the examiner must be careful not to overreact. For instance, loan limits based on seniority should not automatically be considered to be an effects test violation. Before making such a determination, the examiner will need to determine that the majority of members with less seniority are composed of members of a certain race, sex, age group, etc. Also, in most cases, the examiner must be careful not to give the officials the impression that NCUA has determined that a particular loan policy or procedure is definitely in violation of Regulation B based on the effects test. Such a definite determination may be made by NCUA but only after consultation between the examiner, Chief of Consumer Affairs, RD, and OCA.

21.3 CREDIT SCORING

Many larger credit unions have credit scoring systems or are considering implementing such a system. A credit scoring system is a device which assigns to an applicant certain points or weights based on a number of characteristics (usually 8 to 12). Based on the sum of the points the applicant receives, certain probabilities are assigned as to whether or not the applicant is likely to repay the debt. The most obvious advantage to such a system is that it enables credit unions to process a large number of applications quickly. Also, these systems normally are highly predictive of creditworthiness and such systems result in a lower percentage of past due accounts. The disadvantages of credit scoring systems are the cost of implementation and maintenance, and the fact that they can normally be used only by larger credit unions. Other disadvantages relate to certain difficulties encountered as a result of the antidiscrimination provisions of Regulation B.

Regulation B divides credit analysis into two separate categories: judgmental systems and demonstrably and statistically sound, empirically derived credit systems. A demonstrably and statistically sound, empirically derived credit system is defined in Section 202.2(p) of the Regulation. A judgmental system is defined as any other method of credit analysis.

A system is empirically derived if it assigns certain points or weights to certain characteristics of the applicant and the points or weights are derived from an empirical comparison of the entire population of applicants or a statistical sampling of the entire population. A demonstrably and statistically sound, empirically derived system has the added characteristic that it is a system which predicts creditworthiness at a statistically significant rate. Such a system must be periodically revalidated and adjusted as necessary to maintain its predictive ability.

The examiner will advise the credit union to inquire, as part of its decision on purchasing a "credit scoring" system (or to assure that a system it has already purchased is in compliance) whether in building the particular system the data used were the entire pool of applicants or a valid statistical sample of the entire pool. If a statistical sample is used, it must be a sample which would fairly represent the characteristics of the underlying population. A valid applicant pool must include consideration of rejected as well as accepted applications. The examiner should also advise the credit union officials that the system must be revalidated at periodic intervals using valid statistical principles to determine that the system continues to predict creditworthiness at a statistically significant rate. If the system is found to no longer predict creditworthiness at a statistically significant rate, then it must be adjusted. If it is not adjusted, it is no longer a demonstrably and statistically sound, empirically derived credit scoring system.

Some credit unions may mistakenly believe that using a credit scoring system will protect them absolutely from successful prosecution of discrimination cases, including effects test cases. This reasoning is based on the fact that all points or weights are derived as a result of statistical analysis. Thus, it is reasoned, the use of any criteria can be justified by showing a business necessity (see section 21.2, Effects Test). Several falacies with such reasoning are discussed below. But the most obvious reason why credit scoring systems do not achieve such a result is due to the judgmental override.

Credit scoring systems may be used without a judgmental override, but this is generally not the norm in credit unions. Simply put, a judgmental override is a provision made by the credit union which permits the loan officer or credit committee to grant credit even though the applicant did not have the minimum number of points needed for the system to classify the applicant as creditworthy. In the application of some systems there is a cut-off point below which an applicant is not to receive credit. There is another point at which every applicant having a minimum number of points will be granted credit. Between these two point counts exists a gray area where the loan officer or credit committee judgmentally decides whether or not to grant credit. This gray area is the area in which judgmental override may be utilized. The examiner should caution FCU officials that use of judgmental override lessens the validity of the system and is therefore not recommended.

In Regulation B, only age is treated differently in a demonstrably and statistically sound, empirically derived credit system than in a judgmental system. Age may be considered in a demonstrably and statistically sound, empirically derived credit system while in a judgmental system age may be considered only as it affects a pertinent element of creditworthiness. In practice, however, the use of the credit scoring system differs widely from using a judgmental system. In a typical large credit union, a judgmental system would operate in the following way. The applicant completes a written application. The loan officer, using certain minimum criteria set forth by the board of directors, evaluates the loan application. If he or she feels that the applicant is creditworthy, (for the amount and terms of the credit requested), the loan is granted. If he or she feels that the applicant is not creditworthy, the application will be sent to the credit committee. The credit committee then evaluates the loan application. If the applicant is deemed creditworthy, the loan is made. If the applicant is not deemed creditworthy, the loan application is denied and the applicant is given an adverse action notice detailing the reasons the credit committee denied the application.

When the credit union is using a demonstrably and statistically sound, empirically derived credit system, the application process would work as follows. When the application is received, it is scored either manually or by a machine and a score is obtained. If the applicant receives a score high enough, he or she will be granted credit. If the score is below a certain minimum amount, the loan officer may exercise a judgmental override or the loan may go directly to the credit committee. In almost all cases, the credit committee has a judgmental override.

If the loan is denied, an adverse action notice must be issued. The question of how the adverse action notice is to be completed is currently under consideration by the Federal Reserve Board. At this time, the credit union has several choices as to how this notice may be completed. The credit union may tell the applicant that the application was scored and give as reasons for the adverse action the categories in which the applicant scored the lowest. More than one category must be listed. The credit union may elect to list as the reasons for the adverse action all categories in which the applicant scored below the mean score for each category. Alternatively, the credit committee may review the application judgmentally and list judgmental reasons for the adverse action, even though the applicant is denied credit because of his or her score. This is a less preferable approach.

Earlier it was stated that use of a demonstrably and statistically sound, empirically derived credit system is no assurance that the credit union is granting credit without discriminating (including running afoul of the effects test). The judgmental override has already been discussed as one potential problem. Another is the possibility of a tainted data base.

In credit unions which discriminated in the past, the loan portfolio contains few or no loans of the class discriminated against. It is probable, therefore, that the resulting weights obtained from such a data base will be skewed in favor of the majority applicants and against minority applicants. This is why Regulation B requires that the entire applicant pool, including rejected applicants, be used. Proponents of credit scoring systems claim that consideration of the rejected applicants eliminates any bias in the sample. While this may be true if every applicant completed a written application, it is not true if certain applicants were discouraged from completing an application on a prohibited basis. If this type of pre-screening occurred in the past, then the system could serve to perpetuate discrimination.

Such data bases frequently result in categories which have the effect of discriminating on a prohibited basis. Although a credit scoring system is demonstrably and statistically sound, empirically derived and may show a business necessity, that alone is only part of the effects test. It must also be shown that there does not exist another less discriminatory category which is also highly predictive. It is NCUA's opinion that a small change in predictability would not justify use of a more discriminatory criterion. However, this question has not reached the courts.

Should the examiner determine that a category, or points assigned to certain individuals within a category, results in the system having an adverse impact on a particular protected group, he or she should discuss this with the credit union officials. The officials should be asked to contact the system developer to determine whether the particular category or criterion can be changed, or the points allotted changed, to eliminate the adverse impact without adversely affecting the system's predictability. If it can be changed, it must be. If the officials and/or system developer refuse to change, the examiner will contact the Chief, Consumer Affairs for guidance. All pertinent information will be documented in the Closed Section.

The Federal Reserve Board currently has under consideration several questions concerning whether certain practices violate or do not violate Regulation B. The Board's Federal Register notice is included at Appendix 9. Any credit union employing the practices under consideration should be advised that these practices may in the future be deemed to be violations of Regulation B.

21.4 CONSUMER COMPLIANCE EXAMINATION PROCEDURES

As previously mentioned, ECOA and Regulation B cover every aspect of a credit transaction. This includes, but is not limited to, the following: (a) establishment of lending policies, (b) advertising of loan services, (c) format and content of the loan application form, (d) loan interview, (e) evaluation of loan request, and (f) debt collection procedures. Therefore, the examiner must remain constantly aware of ECOA requirements while performing each examination procedure. This is especially true during the : (a) scan of board minutes, section 9, (b) review of forms, section 14, (c) review of advertising, section

11, (d) review of lending policies, section 10, (e) review of loans, section 15, (f) review of debt collection procedures, section 20, and (g) fair housing, section 22. During the judgmental sample of rejected loan applications, section 15, the examiner will determine compliance with the adverse action notification requirements of Regulation B, Section 202.9.

21.5 HANDLING EXCEPTIONS/VIOLATIONS

Any violations which come under the ECOA uniform enforcement guidelines will be handled in accordance with section 21.6 of this Guide.

Except for a possible effects test problem, all exceptions will be detailed on either NCUA 3013, Loan Review Results, NCUA 3012, Consumer Examiner's Findings, and/or NCUA 3323 Consumer Regulations Compliance Checklist. Possible effects test problems will be reflected on NCUA 3010 , Supplementary Comments and Recommendations. For all repetitive and/or serious violations, the appropriate corrective agreements will be reflected in the Record of Action. Effects test problems will not be reflected in the Record of Action except in those rare cases where NCUA has ruled that a policy or procedure definitely has the effect of discriminating on a prohibited basis. Instead, the corrective agreements reached will be discussed in the Closed Section.

21.6 ECOA UNIFORM ENFORCEMENT GUIDELINES

This section is reserved for the ECOA uniform enforcement guidelines when finalized.

FAIR HOUSING

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APPLICABLE APPENDICES

Appendix 10 Copy of Fair Housing Act

22. GENERAL

The Federal Fair Housing Law, which is part of Title VIII of the Civil Rights Act of 1968, was enacted to eliminate discrimination in any aspect of housing. A copy of the Law is contained in Appendix 10. The law prohibits the denial of a mortgage or home improvement loan to anyone for reasons of race, color, religion, sex or national origin. This includes loans for the purpose of constructing, improving, repairing or maintaining a dwelling. The prohibition against discrimination also applies to the setting of loan terms or other application and collection procedures. An aggrieved party may file a complaint with the Department of Housing and Urban Development (HUD) or NCUA and/or may file suit in U.S. District Court for actual damages, as well as court costs and attorney's fees. Since actions which violate the Fair Housing Law would also be violative of Regulation B (ECOA), the civil penalities under ECOA would also be applicable.

With respect to Federal credit unions, the Fair Housing Law is implemented by Section 701.31 of the NCUA Rules and Regulations. This regulation covers nondiscrimination in lending, appraisals and advertising. Under nondiscrimination in lending and appraisals, the regulation also prohibits practices which have the effect of discriminating on the basis of race, color, religion, sex, or national origin. A discussion on the effects test is in section 21 of this Guide.

22.1 CONSUMER COMPLIANCE EXAMINATION PROCEDURES

The examiner will determine compliance with the Fair Housing Law and Section 701.31 by answering the related questions on NCUA 3323, Consumer Regulations Compliance Checklist. The answers to these questions will be obtained while performing the following examination steps: lending policies, section 10, Home Mortgage Disclosure Act (Regulation C), section 23, advertising, section 11, debt collection, section 20, loan review, section 15, and Equal Credit Opportunity Act (Regulation B), section 21. While performing these examination steps and when discussing the requirements with the appropriate officials and key employees, the examiner will determine if the credit union has established adequate procedures for compliance with the law and regulation.

22.2 HANDLING EXCEPTIONS/VIOLATIONS

All exceptions will be discussed with the appropriate officials and key employees. When possible, the necessary corrective action(s) will be implemented during the examination. The exceptions, except for effects test problems, will be reflected on NCUA 3013 Loan Review Results, NCUA 3012 Consumer Examiner's Findings, and/or NCUA 3323 Consumer Regulations Compliance Checklist. Effects test problems will be reflected on NCUA 3010 Supplementary Comments and Recommendations.

For all repetitive and/or serious violations, the necessary corrective action(s) and agreement(s) will be reflected in the Record of Action. The agreements reached for effects test problems will be discussed in the Closed Section. Violations which come within the ECOA enforcement guidelines will be handled in accordance with section 21.6, ECOA Uniform Enforcement Guidelines, of this Guide.

HOME MORTGAGE DISCLOSURE ACT

(REGULATION C)

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HOME MORTGAGE DISCLOSURE ACT (REGULATION C)

23. GENERAL

The Home Mortgage Disclosure Act of 1975 became effective on June 28, 1976, and was implemented by the Federal Reserve Board's Regulation C. This Act, which is frequently referred to as the "anti-redlining law," grew out of public concern over credit shortages in certain urban areas. Redlining means identifying certain areas of a community as ineligible for mortgage and home improvement credit. This practice stems from discrimination against various groups of residents and typically results in the decline of inner city neighborhoods. The purpose of HMDA is to allow interested groups to review the required disclosure statement thereby revealing any redlining practices to concerned and/or affected members of the general public. Although HMDA and Regulation C themselves do not specifically prohibit redlining, such a practice could be violative of the Fair Housing Act of 1968 and Section 701.31 of the NCUA Rules and Regulations.

NCUA has been designated as the enforcing agency for all credit unions both state and Federally-chartered. With regard to Federal credit unions the reporting requirements of this law apply to any FCU which: (a) made or purchased one or more first mortgage residential real estate loans in the preceding calendar year; (b) maintained its main or any branch office in a Standard Metropolitan Statistical Area (SMSA); and (c) was over $10 million in assets at the end of the preceding fiscal year or the current calendar year. Note that while home improvement loans must be reported on HMDA-1, an FCU is not subject to reporting requirements unless it also makes first mortgage residential real estate loans.

23.1 CONSUMER COMPLIANCE EXAMINATION PROCEDURES

Prior to or immediately after starting the examination of a credit union over $10 million in assets, the examiner will request copies of all HMDA disclosure statements prepared since the previous consumer compliance examination. If the examiner is told that the credit union does not make first mortgage residential real estate loans, this fact can be verified during the (a) review of advertising, section 11, (b) review of lending policies, section 10, and (c) review of loans, section 15.

Where the FCU is found to be subject to HMDA reporting procedures, the examiner will review its procedures for: (a) obtaining and properly compiling the data to be reflected on the HMDA-1 Mortgage Loan Disclosure Statements; (b) making the disclosure statements available to anyone requesting inspection and/or a copy in the main office and at least one branch office in each SMSA, and (c) annually notifying members of the availability of the mortgage loan data. Prior to conducting the loan review, section 15 and fair housing, section 22, portions of the examination, the examiner will review the HMDA-1 disclosure statements to: (a) determine that the format is similar to form HMDA-1, and (b) verify that all required data is being reported and that such data is reported by census tract or ZIP Code. The examiner will also make note of any possibilities of redlining. If noted, this fact and related informative will be taken into consideration during the loan review, section 15, and fair housing, section 22, portions of the examination.

23.2 HANDLING EXCEPTIONS/VIOLATIONS

All exceptions will be discussed with the appropriate officials and key employees. Where possible, the necessary corrective action(s) should be implemented during the examination. The exceptions will be reflected on either NCUA 3012, Consumer Examiner's Findings or NCUA 3323, Consumer Regulations Compliance Checklist. For all repetitive and/or substantive violations, the necessary corrective action(s) and agreement(s) will be reflected in the Record of Action.

REAL ESTATE SETTLEMENT PROCEDURES ACT

(RESPA)

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REAL ESTATE SETTLEMENT PROCEDURES ACT

24. GENERAL

The Real Estate Settlement Procedures Act (RESPA) became effective on June 20, 1975. RESPA is implemented through Regulation X of the Department of Housing and Urban Development (HUD). The purpose of RESPA is to provide borrowers with certain information relating to financing and settlement in connection with real estate loan costs. RESPA also prohibits certain practices, such as kickbacks, and places limitations on escrow accounts. RESPA applies to Federal credit unions which make "Federally related first mortgage residential real estate loans," as defined in Section 3(1) of RESPA and Section 3500.5(b) of Regulation X (reference Part 5 of the Manual of Laws).

24.1 CONSUMER COMPLIANCE EXAMINATION PROCEDURES

The examiner will need to first determine if the credit union makes "Federally related first mortgage residential real estate" loans. This determination can generally be made through discussions with appropriate officials and key employees and the review of lending policies (section 10) and advertising (section 11). If such loans are being made, the examiner will determine if the credit union has established adequate procedures to comply with RESPA requirements. The procedures should provide for the following:

a. Identifying Federally related first mortgage residential real estate loans;

b. Providing the RESPA Special Information Booklet within three days from receipt of the loan application;

c. Developing and providing the required good faith estimate of settlement costs within the required three-day time limit;

d. Developing and providing the Uniform Settlement Statement(HUD-1) within the required one-day time limit;

e. Retaining a copy of the HUD-1 form for two years; and

f. Keeping escrow accounts within the permitted maximums.

24.2 HANDLING EXCEPTIONS/VIOLATIONS

All exceptions will be discussed with the appropriate officials and key employees. The exceptions will be reflected on NCUA 3013, Loan Review Results and NCUA 3323, Consumer Regulations Compliance Checklist. Where possible, the necessary corrective agreements will be implemented during the examination. For all repetitive and/or serious violations, the plans for corrective action will be reflected in the Record of Action.

FLOOD INSURANCE

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[redacted]

FLOOD INSURANCE

25. GENERAL

In order to reduce the annual losses throughout the nation from floods and mudslides and also reduce the construction of homes in areas of flood hazards, Congress passed the National Flood Insurance Act of 1968 and the Flood Disaster Protection Act of 1973. Under the Act, NCUA was directed to issue appropriate regulations with respect to Federal credit unions and Federally-insured state credit unions. Part 760 of the NCUA Rules and Regulations outlines the flood insurance requirements.

25.1 CONSUMER COMPLIANCE EXAMINATION PROCEDURES

The flood insurance requirements apply to any Federal credit union (and Federally-insured state credit union) which makes loans secured by improved real estate or a mobile home. The examiner should be able to determine if the credit union makes such loans through discussions with appropriate officials and key employees and after the review of lending policies (section 10). If such loans are made, the examiner will determine if the credit union has established adequate procedures to comply with the requirements of Part 760. The procedures must provide for the following:

a. Determining where applicable property, e.g. mobile homes, will be located;

b. Determining if the location where the property is (or will be) located is in a special flood hazard area;

c. Determining if the community in the special flood hazard area is participating in the National Flood Insurance Program;

d. Determining if flood insurance, when required, has been obtained and is acceptable insurance under the Flood Disaster Protection Act;

e. Providing the proper written notice(s) to the borrower, when required; and

f. Retaining required records.

25.2 HANDLING EXCEPTIONS/VIOLATIONS

All exceptions will be discussed with the appropriate officials and key employees. The exceptions will be reflected on NCUA 3013, Loan Review Results and NCUA 3323, Consumer Regulation's Compliance Checklist. Where possible, the necessary corrective agreements will be implemented during the examination. For all repetitive and/or serious violations, the plans for corrective action will be reflected in the Record of Action.

PRIVACY AND RELATED LAWS

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PRIVACY AND RELATED LAWS

26. GENERAL

In order to effectively serve the best interests of the general public, the Federal Government must obtain, use and sometimes retain a certain amount of personal information on its citizens and non-citizens residing in the United States. The National Credit Union Administration, as a Government agency, is no exception. In order to protect an individual's right to privacy and to ensure that the Government agencies obtain and use such personal information only when needed, various privacy laws have been passed by Congress. Congress has also passed laws which protect the public's "right to know" what personal information the Governments is collecting and using.

During the examinations and compliant investigations, the examiner must have access to and review personal information on credit unions members. At times, this information must also be discussed with various employees. While performing duties as an NCUa employee, the examiner must remain constantly aware of these privacy and freedom of information laws. In addition, during the examination, the examiner will need to determine if the FCU is fully complying with the Right to Financial Privacy Act which is applicable to both NCUA and credit unions.

26.1 LEGISLATIVE BACKGROUND

The first so-called public information laws was Section 3 of the Administrative Procedures Act of 1946. This act provided that, "matters of official record shall in accordance with published rule be made available to persons properly and directly concerned except information held confidential for good cause found." While the intent of this Act was to make information available to the public, it generally resulted in encouraging the withholding of information rather than disclosure. Government officials who may have previously routinely made inforamtion available now found themselves trying to determine if the persons requesting the information were "properly and directly concerned" and if there was "good cause" for withholding information.

Consequently, in 1958, Congress amended the Government's 1789 "housekeeping" statute which gave Federal agencies the authority to create, maintain, and use government records and files. The Moss-Hennings bill (5 U.S.C. 301) states, "This section does not authorize withholding information from the public or limiting the availability of records to the public." Unfortunately, the amendment had very little effect in making governmental information available to the public.

Therefore, in 1966, Congress passed the Freedom of Information Act (FOIA). The FOIA expressly provided that government records were available to the public unless the records were covered by one of nine exemptions. The sixth exeption specifically provided for the protection of personal privacy. Government agencies generally responded to FOIA in a somewhat less than enthusiastic manner. In 1972, the House Foreign Operations and Government Information

Subcommittee reported that the "efficient operation of the Freedom of Information Act has been hindered by 5 years of foot-dragging by the Federal bureaucracy." As a result of the subcommittee's report, in 1974 Congress enacted amendments to FOIA which took effect on February 19, 1975. The 1974 amendments established specific guidelines under which the government agencies had to operate in order to fully comply with the provisions of FOIA. A discussion of FOIA will be in an upcoming revision of the Manual of Laws.

Also in 1974, Congress passed the Privacy Act of 1975. This Act was passed out of concern for the protection of personal privacy. Areas covered include the collection and dissemination of personal inforamtion and grants individuals access to their own records. The Act specifically prescribes that there be no secret record systems on individuals. A discussion of the Privacy Act will be included in an upcoming revision of the Manual of Laws.

By now, the trend in government was toward more openness at the Federal level. In 1976, the Government in the Sunshine Act (P.L. 94-409 - 5 U.S.C. 552b) was passed. This Act opened to the general public meetings of specified Federal government agencies (now including NCUA). Also, transcripts and minutes of closed meetings must be made available to the public unless exempt under FOIA on one of nine other Sunshine Act exemptions.

In 1978, Congress once again turned its attention towards the area of protection of personal privacy with the passage of the Right to Financial Privacy Act (RFPA). The purpose of RFPA is to protect customers of financial institutions from uncontrolled government access to their account records that are maintained by the institution. Prior to RFPA, customers could not challenge government access to their financial records. Nor did the customer have any way of knowing that personal records were being turned over to a government authority. In United States v. Miller, 425 U.S. 435 (1976), the Supreme Court held that financial records, because they are kept by the institution, are the property of the institution rather than the customer. This ruling meant that the member had no protectable Fourth Amendment interest in records kept by the credit union, nor could the member limit government access to those accounts. It was principally in response to this decision that the RFPA was adopted. Unlike the Privacy Act and Freedom of Information Act (both of which apply to NCUA but not credit unions), the RFPA is applicable to both NCUA and credit unions.

26.2 RIGHT TO FINANCIAL PRIVACY ACT

The Right to Financial Privacy Act (RFPA), 12 U.S.C. §§3401-3421. was enacted as Title XI of the Financial Institution Regulatory and Interest Rate Control Act of 1978 and became effective on March 10, 1979. Its purpose is to protect the personal financial privacy of individual consumers of financial institutions by requiring Federal agencies: (a) to use only specified methods to access consumer records; (b) to notify the consumer that his or her records are being accessed or transferred; (c) to advise the consumer on how to challenge this in court; and (d) to certify to the financial institution that the agency has complied with the Act. The RFPA applies to both NCUA and Federal credit unions.

"Government authority", as used in the RFPA, means any agency or department of the United States, or any officers, employees, or agents representing the above (e.g. the Department of Justice, F.B.I. or U.S. Attorney). Thus, if a financial institution receives a subponea or other request from a state agency, the RFPA would not generally apply.

Some of the more important provisions of the RFPA are as follows:

a. In order to obtain access to the financial records of a FCU member, the Government authority must use one of the following five methods (note that this does not apply to a consumer examiner):

(1) an authorization, signed and dated by the member, which identifies the records being sought, the reasons the records are being requested and the customer's rights under the RFPA;

(2) an administrative subpoena or summons;

(3) a search warrant;

(4) a judicial subpoena; or

(5) a formal written request by a Federal government agency (to be used only if no administrative summons or subpoena authority is available).

b. If a Federal credit union receives a request for information, it may not release the financial records of a member until the government authority seeking such records certifies in writing that it has complied with the applicable provision of the RFPA (Section 1103(b)).

c. Upon receipt of the agency's summons or subpoena or a judicial subpoena, a credit union is required to begin assembling the requested information and must be prepared to deliver the records upon receipt of the written certificate of compliance (Section 1111).

d. Consumer Notice Exceptions - (1) Consumer notice can be delayed for periods up to 90 days if the government can convince the court that notice would result in endangering the life or physical safety of any person; flight from prosecution; destruction of or tampering with evidence; intimidation of potential witnesses; or otherwise seriously jeopardizing or unduly delaying an investigation, trial or official proceeding. In such cases, the credit union will also be ordered, by the court, not to disclose that records were obtained by the Government authority. (2) The notice for search warrants is initially required within 90 days after the search warrant is served. Delayed notice of no longer than 90 additional days is also allowed for search warrants. (3) No notice is required and the consumer does not have the right to challenge any access where the government is engaging in authorized foreign intelligence activities or where the Secret Service is conducting its protective functions. (4) Finally, no notice is required for a grand jury subpoena.

e. Recordkeeping Requirements - (1) When a credit union makes disclosures to a government authority pursuant to a written customer authorization, the credit union must maintain a record of all such disclosures and must permit the member to have a copy of the record (unless prohibited by a court order). The record should include the date, the name of the Government authority, and an identification of the records disclosed (Section 1104 (c)). (2) If the credit union discloses member records to a government authority in connection with a government insured or guaranteed loan, the credit union must make a notation of each disclosure and permit the member to inspect the information (Section 1113(h)(6). (3) Although there are no specific record retention requirements in the Act, credit unions should retain copies of all administrative and judicial subpoenas, search warrants, and formal written requests given to them by Federal agencies or departments along with the written certification required by Section 1103(b).

f. Cost Reimbursement - Credit unions may receive payment from any government authority requesting information pursuant to the RFPA. This may include costs for assembling or providing records, reproduction and transportation costs, or any other costs reasonably necessary or incurred in gathering and delivering requested information. This does not apply to NCUA's access to member records in Federally-insured credit unions. The Federal Reserve Board's Regulation S establishes the rates that may be charged.

g. Civil Liability/Penalties - (1) If a government authority obtains, or a credit union discloses member records in violation of the RFPA, the government authority or the credit union could be liable to the member for $100, plus actual damages, plus punitive damages (if the court finds an intentional violation), plus court costs and reasonable attorney's fees. However, a credit union that relies in good faith upon a government authority's certification of compliance cannot be held liable for disclosure of financial records. (2) The personnel of a government authority will be subject to disciplinary actions recommended by the agency charged with enforcement if a court determines that the personnel involved acted willfully or intentionally with respect to a violation of the RFPA. (3) Any action can be brought up to three years of the date of violation or the date of its discovery, whichever is later.

There are various types of disclosures which are exempt from the formal access requirements of the RFPA. These exemptions are listed as follows:

a. notification by a financial institution to a government authority that the financial institution has information relevant to a possible violation of law or regulation (Credit unions should be advised that, when notifying a government authority, only information not identifiable as being derived from a particular member's records should be disclosed.);

b. disclosure necessary to perfect a security interest, prove a claim in bankruptcy, or collect on a debt;

c. disclosure necessary in connection with a government insured or guaranteed loan (the credit union must keep records of these disclosures and allow the member's to see this record);

d. disclosure of information not identifiable as being derived from a particular member's records;

e. disclosure to the credit union's supervisory agency (This means that NCUA personnel may obtain access to the member records of any Federally-insured credit union without giving the credit union a certificate of compliance, without giving the members prior notice, and without having to use one of the prescribed methods of requesting access. This exception will apply to consumer compliance examinations, initial contacts, follow-up examinations, investigation of consumer complaints, and other cases where disclosure is necessary as part of NCUA's supervision and regulation of Federally-insured credit unions.);

f. disclosure in accordance with procedures authorized by the Internal Revenue Code;

g. information required to be reported by federal law or regulation;

h. disclosures in connection with litigation (including administrative hearings) where the government authority and the consumers are parties;

i. disclosure of the name, address, account number, and type of account of a member, or a group of members, associated with a financial transaction or class of transactions (the formal methods of access must be used but member notification is not necessary);

j. disclosure in connection with a lawful proceeding or investigation directed at the credit union (the certificate of compliance must be given to the credit union);

k. disclosure pursuant to a grand jury subpoena; and

l. disclosures to the General Accounting Office in connection with a proceeding, investigation or audit directed at a government authority.

In certain limited cases, NCUA may require access to the records of customers of financial institutions other than Federally-insured credit unions. If so, NCUA must comply with the formal requirements of the RFPA. Also, at times, NCUA may desire to transfer member records or information obtained from a credit union to another government authority; e.g., criminal referrals to the FBI. In such cases, certain specific procedures must be followed depending upon whether the records or information are identifiable as being derived from a particular member's records.

26.3 CONSUMER COMPLIANCE EXAMINATION PROCEDURES

While performing the various examination steps (particularly the review of board and executive committee meeting minutes, section 7), the examiner will make note of any instances when a member's records were requested by a government authority. During the latter part of the examination, the examiner will discuss the requirements of the Right to Financial Privacy Act with the key operating official/employee (usually the treasurer, assistant treasurer or manager). During this discussion and while answering the related questions on NCUA 3323, Consumer Regulations Compliance Checklist, the examiner will determine: (a) if the official/employee is familiar with the RFPA's requirements, (b) if procedures and internal controls have been established for fulfilling requests by government authorities in compliance with the RFPA, and (c) if any requests for member records by a government authority have been received during the examination period. If a government authority has made a request, the consumer examiner will determine compliance with the RFPA's requirements.

26.4 HANDLING EXCEPTIONS/VIOLATIONS

Answers to questions 1 and 2 on NCUA 3323 reflect a credit union's familiarity with the RFPA but do not indicate that the credit union has violated the Act. If the answers to these questions reflect that the key official/employee is not familiar with the requirements of the RFPA and/or that the FCU has not established procedures to comply with the RFPA's requirements, the examiner will discuss with the appropriate official and/or key employee the general requirements of the RFPA and direct the official/employee to the more specific discussion in the Manual of Laws Affecting Federal Credit Unions (after inclusion). The examiner will recommend that the FCU establish adequate procedures and internal controls to comply with the RFPA's requirements. These recommendations will be reflected on NCUA 3010, Supplementary Comnments and Recommendations. Following is suggested wording for this recommendation: "Credit unions and other financial institutions are responsible for ensuring that consumers' financial records are disclosed to government authorities in accordance with the RFPA. During our examination we discussed the RFPA's general requirements and recommended, as emphasized here, that the credit union officials become familiar with the RFPA's requirements and establish the necessary procedures required by the Act."

If, during the examination period, the FCU fulfilled requests by government authorities and violated any provisions contained in the RFPA, the specific violation(s) will be discussed with the appropriate official and/or key employee and the necessary prospective corrective agreements will be obtained.

All exceptions/violations noted will be detailed on NCUA 3012, Consumer Examiner's Findings and compliance documented on NCUA 3323, Consumer Regulations Compliance Checklist. For all serious and/or repetitive exceptions/violations, the necessary plans for corrective action will be reflected in NCUA 3009, Consumer Compliance Record of Action.

26.5 REFERENCES - STUDY GUIDES

a. National Credit Union Administration Rules and Regulations - Part 720

b. Right to Financial Privacy Act

c. Manual of Laws Affecting Federal Credit Unions - Part 10

d. NCUA Instructions Nos. 3212, 3226, and 3236

SHARE DISCLOSURES

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SHARE DISCLOSURES

27. GENERAL

Section 701.35(1) of the NCUA Rules and Regulations is NCUA's "Truth in Savings" regulation. It was developed to ensure that Federal credit union members receive necessary and useful disclosures concerning their share accounts. The regulation, which was originally promulgated in 1977, was revised in 1980 to clarify certain disclosure requirements and impose additional requirements.

The reason for the savings disclosures is to prevent member dissatisfaction, poor member relations, and complaints to NCUA. The regulation requires disclosure of certain terms and conditions that affect members' savings. For example, FCUs with quarterly dividend periods must disclose that no dividend will be paid on funds withdrawn before the end of the dividend period. The disclosures are helpful for members' money management, and they also serve a useful consumer education function.

The regulation requires that credit unions provide disclosures to members when they open new accounts. The disclosures must be given to members when an account is opened in person; they must be mailed if an account is opened by mail or telephone. The disclosures must be given to each member. A notice in the lobby will not suffice.

The regulation also requires that disclosures be provided when changes are made in existing account. These disclosures must be mailed (or given) to each member affected by the change. A newsletter article accompanying a quarterly statement would satisfy the requirement. As in the case of new accounts, a notice in the lobby will not suffice.

27.1 CONSUMER COMPLIANCE EXAMINATION PROCEDURES

The examiner will determine compliance with Section 701.35(1) by completing NCUA 3025, Share, Share Draft, and Share Certificate Disclosure Forms, and the related questions on NCUA 3323, Consumer Regulations Compliance Checklist.

a. Forms Review

The examiner will review all share discoosure forms in use by the FCU. If the credit union uses a multi-purpose form with checkoff blocks or blanks to be filled in, the examiner will review of the form as used for each purpose.

b. Disclosures for New Accounts

The examiner will determine if the FCU has procedures in place to assure that disclosure statements are given each time a new account is opened. For example, the examiner will review any internal checklists that FCU staff follow when opening new accounts.

c. Changes in Existing Accounts

The examiner will ask if any changes have been made in the terms and conditions of existing accounts in the past year. (This may also be determined during the review of the board minutes.) If any changes have been made, the examiner will use appropriate procedures to determine if the credit union provided the required disclosures to those members whose accounts were changed.

27.2 HANDLING EXCEPTIONS/VIOLATIONS

All exceptions/violations will be discussed with the appropriate officials, and key employees. The exceptions/violations will be documented on NCUA 3323, Consumer Regulations Compliance Checklist, and NCUA 3012, Consumer Examiner's Findings. Where possible, the necessary corrective agreements will be implemented during the examination. For all repetititve and/or major violations, the plans for corrective action will be documented in the Record of Action.

27.3 REFERENCES/STUDY GUIDES

National Credit Union Administration Rules and Regulations - Section 701.35(1), Share Disclosure.

PREPARATION OF REPORT

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PREPARATION OF REPORT

30. GENERAL

The consumer compliance examination report is important in the supervision of credit unions. It represents a channel of communication between the consumer examiner, the credit union, and NCUA.

The exhibits and schedules included in the typewritten report have the primary function of supporting the comments in the narrative sections. The attention of the officials and NCUA will ultimately focus upon these sections. The information on the schedules and in the narrative sections must be accurate, clear, and concise.

The report will consist of a cover page, NCUA 3007, and the following narrative sections:

a. Regional Office Comments and Recommendations, NCUA 3201

b. Consumer Compliance Statement of Responsibility, NCUA 3008 or the NCUA 3004 (Certification of Consumer Compliance Examination) when a Record of Action is not used.

c. Consumer Compliance Record of Action, NCUA 3009 and 3009a.

d. Supplementary Comments and Recommendations, NCUA 3010

e. Consumer Compliance Closed Section, NCUA 3011

The first four are part of the "open" section and are to be written to the credit union officials. The closed section is for NCUA use only.

Except for NCUA 3201, Regional Office Comments and Recommendations, the cover page and the narrative sections will be completed by the examiner after the completion of the on-site portion of the examination. In most cases, the report will not be prepared at the credit union, although this is permissible. Therefore, the examiner should ensure that he or she has all the necessary information prior to leaving the credit union.

The report should be prepared and mailed to the regional office as promptly as possible after completion of the on-site phase of the examination. The sooner the report is prepared, the better able the examiner will be to remember all the pertinent details of the examination. While in a travel status, however, the examiner will normally complete two to four examinations and then prepare the reports at his or her residence. Without obtaining clearance from the Chief of Consumer Affairs, the examiner will not have more than six outstanding reports at one time. All reports will be completed and mailed to the regional office within 15 working days of completion of the on-site phase of the examination.

30.1 REGIONAL OFFICE COMMENTS AND RECOMMENDATIONS, NCUA 3201

The Regional Office Comments and Recommendations, NCUA 3201, is for regional office use only. On this form, the Chief of Consumer Affairs will make comments and recommendations (if any) believed advisable after the review of the report in the regional office. NCUA 3201 may be used for the following purposes: (a) to emphasize the seriousness of one or more problems noted during the examination, (b) to relay to the officials the final determination on any questionable exceptions/violations which could not be cleared prior to the conclusion of the examination, and (c) to bring to the attention of the officials exceptions/violations noted from the review of the report which were not addressed by the examiner.

Depending on the circumstances, the Chief may contact the examiner about any comments to be reflected on NCUA 3201 prior to mailing the report to the credit union. In all cases, a copy of NCUA 3201, when used, will be forwarded to the examiner. If the examiner is not in agreement with any comments or recommendations made on NCUA 3201, he or she should promptly discuss the matter with the Chief.

30.2 CONSUMER COMPLIANCE STATEMENT OF RESPONSIBILITY

The major part of the Statement of Responsibility is preprinted. It states, in general terms, the responsibilities of NCUA and the credit union officials. The only information the examiner needs to provide on this form is a listing of major areas of concern (major problems). These problems should be listed very briefly, often in only two or three words, and in a constructive rather than negative style. The examiner should not attempt to describe the problem in detail on this form, nor its basic causes. The basic causes should be determinable by the plan for action designed to correct the problem. All letters of the major problem areas will be capitalized, and the titles will be double spaced to facilitate editing in the regional office, if necessary. Where feasible, the problems should be listed in order of persistency and/or severity. Examples of how items might be listed on the statement of responsibility are as follows:

INITIAL OPEN-END DISCLOSURES
STATEMENTS OF ACCOUNT
LENDING POLICIES
CREDIT EVALUATIONS
CREDIT REPORTING
DEBT COLLECTION PROCEDURES
REAL ESTATE LOANS
SUPERVISORY COMMITTEE

The examiner will avoid listing "general" problems that cover a broad area. He or she needs to be specific so that the plans for action shown on the Record of Action form can be directed to the specific problem(s). Examples of "general" problem areas are as follows:

REGULATION Z
EQUAL CREDIT OPPORTUNITY ACT

The Statement of Responsibility, NCUA 3008, will be retyped in the regional office for inclusion in the formal examination report. If the credit union has no major problems (areas of concern), the examiner need not include the Statement of Responsibility in the report. A copy of NCUA 3004 (Certificate of Consumer Compliance Examination) will be included instead of NCUA 3008 (see section 30.3).

30.3 CERTIFICATION OF CONSUMER COMPLIANCE EXAMINATION

When no majors areas of concern exist (a Record of Action is not prepared) the examiner will complete the NCUA 3004. This form will be typed in the Regional Office and included in the final report to the FCU officials.

30.4 CONSUMER COMPLIANCE RECORD OF ACTION, NCUA 3009 and 3009a.

The Consumer Compliance Record of Action, NCUA 3009 and 3009a., is a single copy form which will be used during examinations. The content will be typed, when possible. If handwritten, it must be legible so it can easily be copied in the regional office. When typed by the examiner, it will be double spaced to facilitate editing in the regional office if any is necessary. Spelling must be accurate and proper grammar will be used to minimize the need for editing.

The Consumer Compliance Record of Action will follow the Statement of Responsibility which in turn will follow the cover page when the examination report is assembled for submittal to the regional office.

If there are no areas of concern, the Consumer Compliance Record of Action form need not be submitted to the regional office with the workpapers.

An example of a completed Consumer Compliance Record of Action form is included as an appendix to the Guide. When completing the Record of Action, the examiner will follow the following instructions:

a. The titles of the areas of concern will appear as listed on the Statement of Responsibility and the titles will be underlined. The titles will be extended two or three spaces to the left of the plans for action.

b. The plans for action will be listed under the area of concern in the following outline form:

A.
B.
  1.
  2.
    a.
    b.
      (1)
      (2)
        (a)
        (b)

The individual plans for action will not be preceded by a letter or number unless there is more than one plan. For example, there should not be an "A" without a "B", a "1" without a "2", and so forth.

c. The plans for actions will be worded as briefly as possible without sacrificing clarity. Abbreviations will not be used. When possible, the plans will begin with an action verb with the subject being the understood official or employee named in the second column.

d. The second column will contain the name and position of the official or key employee who was or should be assigned to perform the specific step included in the plan for action, and the date the step is to be completed. For uniformity, the first line will contain the first initial and last name of the responsible person, the second line the title, and the third line the completion date. Where applicable, the titles will be abbreviated as follows:

Pres
Vice-Pres
Treas
Bd Secty
Bd Mbr
Cr Comm Ch
Cr Comm Mbr
Sup Comm Ch
Sup Comm Mbr
Loan Off
Mgr
Asst Mgr
Asst Treas
Compl Off

e. After an official has been identified in the Consumer Compliance Record of Action by both name and title, the examiner may eliminate either the name of the official or his or her title in subsequent steps for the Consumer Compliance Record of Action. The criterion for elimination is that the responsible official would be easily identifiable. (i.e., Treasurer would be acceptable while Board Member would not since it does not identify one specific official.)

f. When plans for corrective action have been reflected in the Consumer Compliance Record of Action of the previous examination, and the officials have failed to take the required corrective action, the examiner should note this fact in the ROA. This notation should take the form of a footnote to the ROA similar to the following:

"Similar plans were identified in one or more previous consumer compliance examination reports without adequate corrective action being taken by the officials."

g. The Statement of Responsibility points out in the pre-printed section that unless otherwise indicated, the plans for action shown in the Consumer

Compliance Record of Action were adopted by the board of directors or were agreed upon by individual officials or key employees who have primary responsibility in the particular areas involved. If the plan is not accepted or agreed upon by the board or key officials, it will need to be one designed by the examiner and recommended for implementation. When the plan is not agreed to, the examiner will indicate by use of asterisks and footnotes on the Record of Action form that the plan described was not agreed upon, but that it is, nevertheless, being recommended for adoption. An example of a typical footnote might be "*This plan for action, although not approved by the credit union officials, is recommended for adoption to eliminate the problem shown as the area of concern." When a part of a plan is not adopted the asterisk should be placed next to the specific part involved. In the Closed Section, the examiner should state why the officials would not adopt an acceptable plan for action, and what they intend to do to alleviate their problem.

h. The last column will be completed by the credit union.

i. Where the examiner believes that documentation to support corrective action is required in addition to the follow-up copy of the Record of Action form the individual Record of Action item should indicate that two officials must send supporting documents along with the follow-up copy of the Record of Action.

30.5 SUPPLEMENTARY COMMENTS AND RECOMMENDATIONS, NCUA 3010

The Supplementary Comments and Recommendations will be used to make a record of and discuss matters which cannot be appropriately handled elsewhere in the formal report to the credit union. A copy of a properly completed Supplementary Comments and Recommendations is contained in an appendix to the *Guide*. The form will generally be used to *encourage* correction of policies and practices which are or may be resulting in inequitable treatment of some members or which *may possibly* result in a violation of a consumer law or regulation, *e.g.*, nonconformance to NCUA debt collection guidelines, possible "effects test" problems, unfair lending policies, and other questionable (but not illegal) practices. The form will be typed when possible and double spaced to allow for regional office editing, if necessary. The form will be retyped in the regional office for inclusion in the formal report to the credit union.

The form is essentially a narrative presentation of important matters and for each will reflect: (a) a description of the policy or practice, (b) a clear and concise explanation of why the policy or practice should be discontinued, and (c) realistic recommendations for corrective action. If more than one area is being discussed, each area will be titled. When preparing the form, the examiner will use correct spelling and grammar.

The form is a tool for training officials and employees and obtaining correction of questionable practices to the extent possible without having to promulgate a regulation. The examiner will need to determine why the questionable policy or practice is being used and (to the extent possible) recommend reasonable alternatives which will accomplish the same objectives in a more acceptable fashion (refer to section 5).

If there are no supplementary comments and recommendations, the form will not be included with the workpapers submitted to the regional office.

30.6 CONSUMER COMPLIANCE CLOSED SECTION, NCUA 3011

The upper portion of this form provides for certain information regarding the examination.

The Closed Section is important to the regional office and the next examiner to determine how the objectives of the examination are being achieved. It should supplement the information given in the open section. It should not reiterate what is already stated in the open section.

The important corrective and constructive work accomplished during the examination should be reported in this section. The comments should be brief, but complete enough to show clearly what action was taken. To merely state that certain matters were "discussed" adds little, if anything, to the quality of the report. Of particular importance is an explanation of what was accomplished during any meetings. The Closed Section shall state what formal action was taken and how the major problems will be dealt with. Agreements reached with officials, not commented on in the open sections of the report, will be recorded in the Closed Section. Additionally, comments will be necessary if restitution is required. Refer to section CCE-16.6(c).

An outline form of presentation will be used in the interest of brevity. Lengthy detailed discussions should be avoided. Appropriate topical headings will be used to improve readability and facilitate quick reference. The Closed Section will be single spaced with double spacing provided between topics.

Pertinent matters of a private or restricted nature and personal opinions based on the examiner's observations should be included in the Closed Section. Appraisal of a new credit union's prospects, and comments concerning the attitudes and abilities of the officials and difficulties that may be facing the credit union in the future are examples of the types of material to be presented. The examiner should use this section as extensively as necessary, but it will not be cluttered with facts or opinions that are inconsequential or irrelevant.

As an aid to the next examiner, any special circumstances or information disclosed by the files will be set forth in this section.

Recommendations for follow-up examinations to be conducted prior to the next regularly scheduled examination will be contained in this section. As a minimum, the examiner will comment in the Closed Section on the following: (In order to promote readability these topics will be commented on in the same sequence as presented below.)

a. Membership services,

b. Management Ability (in consumer compliance areas),

c. Problem areas and expected date(s) major problem(s) will be resolved,

d. Follow-up plans or plans for next consumer compliance examination, and

e. Recommendations (should always be last topic discussed).

The examiner should conduct each examination in such a manner that a follow-up examination will usually not be necessary. In some instances, conditions such as serious violations of regulations or TiL or ECOA uniform enforcement actions may indicate the need for a contact before the next regularly scheduled examination. In these cases, the examiner will indicate in the Closed Section his or her plans for a follow-up examination, when it will be made, and what items will be reviewed during the follow-up examination.

When the Consumer Compliance Record of Action reflects a major problem which was also treated as a major problem during the previous examination, the examiner will discuss, in detail, why administrative action is or is not being recommended. This information will be reflected under "Recommendations" in the Closed Section.

ASSEMBLY OF WORKPAPERS FOR SUBMITTAL TO REGIONAL OFFICE

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ASSEMBLY OF WORKPAPERS FOR SUBMITTAL TO REGIONAL OFFICE

31. GENERAL

In order to achieve uniformity in the submittal of workpapers and to facilitate the review and release of each report, all current examination workpapers will be assembled in the sequence outlined below prior to mailing to the regional office. All of these workpapers may not be used in every examination. If a workpaper is not applicable to a particular examination, it need not be included in the report submitted to the regional office.

All materials will be placed under the acco fastener (from top to bottom). If a memorandum accompanies the report, it will be attached by paper clip to the top of the report. Additionally, the regional office and Washington office copies of all applicable forms will be attached by paper clip to the top of the report.

31.1 ORDER OF WORKPAPERS

NCUA Form Number	Title of Workpaper
3001	Request for Administrative Action
3002	Complaint Investigation Report
4501	Report of Officials
3324	Consumer Regulations Compliance Summary

3323	Consumer Regulations Compliance Checklist
3004	+ Certification of Consumer Compliance Examination
3005	Notification of Compliance Rating
*3006	Consumer Compliance Examination Information Worksheet
3007	+ Consumer Compliance Examination Report
3008	+ Consumer Compliance Statement of Responsibility
3009	Consumer Compliance Record of Action
3010	Supplementary Comments and Recommendations
3011	Consumer Compliance Closed Section
3012	Consumer Examiner's Findings
3013	Consumer Compliance Loan Review Results
3014	Board/Executive Committee Minutes
3015	Regulation Z - Initial Open End Disclosure Form
3016	Regulation Z - Closed End Credit Disclosure Form
3017	Statement of Account
3021	Lending Policies
3022	Lending Policies and Procedures
3023	Loan Application
3024	Adverse Action Notice
3025	Share Account and Share Certificate Disclosure Form
3026	Advertisements
3027	Special Recommendations Checklist
3028	Consumer Compliance Profile of Loans
--	Informal Notes and Workpapers

+Whichever is appropriate.
*Indicates a continuing workpaper.

RETURN OF REVIEWED REPORTS TO THE CONSUMER EXAMINER

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RETURN OF REVIEWED REPORTS TO THE CONSUMER EXAMINER

32. GENERAL

After the typed report has been released to the credit union by the regional office, the edited pencil copy of the report, copy of NCUA 3201, Regional Office Comments and Recommendations (if prepared), copy of any transmittal letters and memorandums, and a copy of NCUA 3203, Appraisal of Consumer Compliance Examination Report (if report is reviewed) will be returned to the examiner-in-charge (EIC) of the consumer compliance examination. If the EIC is not the district consumer examiner, the EIC will, after his or her review, forward the report to the district consumer examiner. Reports will not be returned to examiners for examinations they performed while on detail to another region.

32.1 CONSUMER EXAMINER REVIEW AND FILING

Upon receipt of the report and workpapers from the regional office, the examiner should immediately review the report. Special attention should be directed to the edited portions of the narrative sections of the report, changes to or comments on the workpapers, the transmittal letter (if one was prepared) and the appraisal (if there was one). If the examiner believes that the report as changed does not reflect what he or she intended, he or she should immediately contact the Chief of Consumer Affairs and furnish complete data in this connection. Any follow-up examinations scheduled by the examiner will be carried out as planned unless otherwise instructed by the Chief. Where follow-up action is needed, the examiner should note his or her itinerary or work plans to be sure that the assignment will be completed within the time limit specified.

In the interest of keeping only relatively current data in the field files and to keep them from becoming excessively bulky, it is suggested that when the current examination report is received by the examiner, the workpapers from the report of the previous examination be destroyed. The open section (refer to section 30); NCUA 3011, Closed Section; NCUA 2523 and 2524, Consumer Regulations Compliance Checklist and Summary; NCUA 3012, Consumer Examiner's Findings; NCUA 3013, Consumer Compliance Loan Review Results; and NCUA 3027, Special Recommendations Checklist will be retained in the field files through the next two examinations. Under this procedure, the field file will always contain the latest report, including its workpapers, plus the open and closed sections and pertinent supporting workpapers of the previous two examination reports.

Continuing type workpapers (refer to section 31), when completely filled in, will be retained and submitted with the next two examination reports so that continuity can be maintained and trends reviewed. The completed continuing type work papers may then be destroyed.

SUPERVISION

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SUPERVISION

S1 GENERAL

The regional director is responsible for the overall supervision of Federal credit unions in the region. The Chief of Consumer Affairs has been delegated the responsibility for determining that the supervisory work of the consumer examiners is carried out in accordance with NCUA policies. The examiner is directly responsible for the supervision of the credit unions in his or her district and normally carries out this responsibility with little or no guidance from the Chief of Consumer Affairs other than the issuance of work assignments. In complex situations the Chief of Consumer Affairs may assist the examiner by advising or even participating in the supervisory efforts.

If a supervisory effort cannot be scheduled and performed within the required time frame, the examiner shall promptly notify the Chief of Consumer Affairs. This notification will be made as soon as possible to allow the Chief of Consumer Affairs ample time to consider and implement alternative plans.

S1.1 TYPES OF SUPERVISION EFFORTS

Examiner supervisory efforts will be composed of two types: (a) Initial contacts, and (b) Follow-up examinations. Both types of supervisory efforts will be discussed in the following sections.

S1.2 INITIAL CONTACT

a. General:

The initial contact is important since the guidance and instructions offered by the examiner will help the new officials understand the role of the examiner more clearly. If the officials are given proper guidance during the early stages of the credit union's existence, the likelihood of serious problems emerging will be minimized.

The initial contact will be made not earlier than   nor later than   from the date of the charter unless travel and per diem costs would be excessive. If the contact is not made within that period, the reasons for the delay and anticipated date that the contact will be made will be communicated to the Chief of Consumer Affairs, who in turn will keep the regional director informed. Also, once the initial contact has been completed, the reason(s) for not conducting the contact within the proper time period will be stated in the initial contact report.

It is the Administration's goal to perform all initial contacts on an average of per contact. Most of this time will be spent in discussion with various officials and employees. Any substantial deviation from per contact will be adequately discussed in the initial contact report.

b. Initial Contact Procedures:

(1) To avoid lost time in locating records and to assure that key officials and employees will be available for discussion, the examiner will give advance notice of the contact to the president, treasurer, manager and/or other appropriate officials/employees.

(2) All pertinent forms (share and loan) to be used by the FCU will be reviewed. In many cases these forms will be standard forms supplied a trade association, an insurer, or another major form supplier. Since these forms will have been reviewed previously, it should be possible to review these forms quickly. Any problem areas noted on the forms will be discussed with the appropriate officials/employees. Refer to section 14 for procedures to be used regarding unacceptable forms.

(3) Meetings with appropriate employees will be conducted to discuss completion of the disclosure forms. Particular emphasis should be placed on the types of loans and share transactions which the FCU will probably encounter during its first 12 to 18 months of operation. Particular emphasis will also be given to common problem areas (e.g., odd first payment periods, required deposit balances, etc.) and methods of complying with the necessary disclosure requirements.

(4) Loan policies will be reviewed with the appropriate officials and

employees. Problem areas regarding the Equal Credit Opportunity Act, Fair Housing Act and the Federal Credit Union Act will be discussed in detail. Care should be taken to avoid giving the impression that suggestions are actually requirements. Suggestions should be clearly identified as such during t e discussions.

(5) Advertising requirements (including Truth in Lending, Fair Housing, share accounts and certificates, etc.) will be discussed. Emphasis should be placed on "trigger terms" and required terminology. The necessity that all advertising be clear and conspicuous and understandable will also be discussed.

(6) During the initial contact it is important that the examiner meet with at least certain key officials and empolyees. At a minimum, the examiner will meet with the president, treasurer, and manager. If the president is unavailable, the vice-president may be substituted. Additionally, the chairpersons of the supervisory committee and credit committee should be invited to attend discussions during the contact.

(7) During these discussions, the examiner will explain the purpose of the examination and supervision program. At all times the examiner will be courteous and helpful. It should be remembered that most officials are volunteers and are devoting their time and efforts at no charge. Harsh criticism should be avoided. Major problem areas, if encountered, will not be overlooked. But in dealing with them, the examiner should be mindful that they probably resulted from inexperience rather than neglect. Therefore, tact in pointing them out and skill in developing solutions will be used.

c. Initial Contact Report:

NCUA 3002, Initial Contact Report will be completed for each initial contact. Instructions for completion are contained on the form. Distribution will be made as instructed on the form.

NCUA 3009, Consumer Compliance Record of Action, will be completed for each major area of concern noted during the contact. At least one copy will be left with the FCU officials. Again, it should be noted that these problems are probably caused by inexperience, not neglect. The problems and corrective action will be discussed with the officials to assure their understanding. A helpful, sympathetic approach will be used when developing plans for corrective action.

S1.3 FOLLOW-UP EXAMINATION

a. General:

Follow-up examinations are to be scheduled in accordance with assigned compliance ratings and with plans reflected in the Closed Section of the consumer compliance examination report unless alternative instructions have been provided by the Chief of Consumer Affairs. The purpose of the follow-up examination is to assure that specific problems noted during an examination have been corrected. As with the initial contact, advance notice will be given to the officials. Normally, the follow-up examination will not be scheduled earlier than from the effective date of the previous examination or follow-up examination. If the follow-up examination cannot be performed within this time frame, the Chief of Consumer Affairs will be notified as soon as possible. The reasons for the delay and anticipated starting date will be provided. If necessary, the Chief of Consumer Affairs may provide alternative instructions. The Chief of Consumer Affairs will keep the regional director informed.

It is the Administration's goal to perform all follow-up examinations on an average of 8 to 12 hours per exam. Good pre-planning and an orderly approach will enable the examiner to utilize time efficiently in accomplishing desired results. If conditions at the credit union are such that more than normal time is necessary, the examiner will contact the Chief of Consumer Affairs. The Chief of Consumer Affairs and the examiner will discuss the amount of time anticipated to be necessary and the reasons. Guidance may be provided by the Chief of Consumer Affairs. The reasons for the excess time will be documented in the follow-up examination report.

b. Follow-up Examination Procedures:

(3) Meetings with appropriate officials/employees will be conducted

to determine what corrective action has been implemented. Appropriate documents, disclosures, loan files, procedures, etc. necessary to determine the effects of the corrective action will be reviewed.

c. Special Procedures - Truth in Lending Reimbursement:

During the follow-up examination, the examiner will verify the accuracy of the Truth in Lending reimbursements as follows:

(1) The examiner will obtain and review the FCU's completed Reimbursement Worksheet (NCUA 3307). Using this worksheet, the examiner will randomly select for which reimbursement was made. The examiner will calculate the reimbursement amount according to established guidelines and procedures to assure proper calculation by the FCU.

If errors in determining reimbursement amounts are found in any of the loans verified by the examiner, the number of loans verified will be expanded to determine the cause of the error. (The error(s) may result from an incorrect factor being used, one or more individuals calculating reimbursement incorrectly, etc.) When the cause of the error(s) is determined, the FCU will be required to review applicable loans and correct any errors. The examiner shall contact the Chief of Consumer Affairs prior to requiring such additional reimbursement.

(3) The examiner will assure that the proper accounting entries were made to accurately reflect the reimbursement on the FCU's books and records. The examiner will have any necessary correcting entries made during the follow-up examination, if possible.

(4) The examiner will have the FCU officials complete NCUA 3306, Report After Reimbursement and forward it to the regional office.

d. Consumer Examiner Recommendation:

At the end of each follow-up examination, in the Follow-up Examination Report, the examiner will make one of the three following assessments:

(1) Satisfactory - This indicates an FCU with an overall rating at the completion of the follow-up examination of a "1", "2", or "3". A "1" indicates that the FCU is in full compliance in all areas at the completion of the follow-up examination. A "2" indicates that the FCU is in non-compliance at completion of the follow-up examination, but that the violations were not noted during the previous consumer compliance or follow-up examination and that they are not sufficiently severe to warrant treatment in the Record of Action. A "3" indicates that the FCU is in non-compliance at the conclusion of the follow-up

examination, but agreements to correct were reached with the officials; the exception was not treated in the Record of Action in the previous consumer compliance or follow-up examination; and, the exception is sufficiently severe to warrant treatment in the Record of Action for this follow-up examination.

(2) Marginal - This indicates an FCU with an overall rating at the completion of the follow-up examination of a "4", "5", "6", or "7". A "4" indicates that the FCU is in non-compliance at the conclusion of the follow-up examination; agreements to correct the problem area(s) were reached with the officials; the exception was treated in the Record of Action of the previous consumer compliance or follow-up examination report; and, the exception is being treated in the Record of Action for this follow-up exam. A "5" indicates that the FCU is in non-compliance at the conclusion of the follow-up exam; agreements to correct the problem area(s) were reached with the officials; the exception was treated in the Record of Action of the two previous consumer compliance or follow-up examination reports; and, the exception is being treated in the Record of Action for this follow-up exam. A "6" indicates the FCU is in non-compliance at the conclusion of the follow-up exam; agreements to correct the problem area have not been reached with the officials; and the exception is being treated in the Record of Action for this follow-up exam. A "7" indicates that the FCU is in non-compliance at the conclusion of the follow-up exam; the Truth in Lending or Equal Credit Opportunity uniform enforcement actions are involved; and, the

exception is being treated in the Record of Action for this follow-up exam.

If the examiner considers the FCU to be "marginal" (as defined above) at the conclusion of the follow-up exam, another follow-up examination will normally be scheduled within from the date of the present follow-up exam. In rare cases, the examiner may determine that a follow-up examination need not be scheduled or need not be scheduled within the time period. If so, the reasons for postponing or not scheduling another follow-up examination will be documented in the Follow-up Examination Report, NCUA 3303. After reviewing the report, the Chief of Consumer Affairs may decide that another follow-up examination is necessary or that the time period be changed. If so, the Chief will contact the examiner and provide appropriate guidance.

(3) Unacceptable - This indicates an FCU with an overall rating at the conclusion of the follow-up examination of "8". This indicates that the FCU is in non-compliance at the conclusion of the follow-up examination and that administrative action is being recommended or continued. The problem area(s) will be included in the Record of Action.

Another follow-up examination will always be scheduled when an FCU is considered "unacceptable" (as defined above) at the conclusion of the present follow-up exam. Refer to section "AA" for procedures regarding recommending implementation or continuance of administrative action.

e. Follow-up Examination Report:

NCUA 3303, Follow-up Examination Report, will be completed for each follow-up exam. Instructions for completion are contained on the form. Distribution will be made as instructed on the form.

NCUA 3324, Consumer Regulations Compliance Summary, will also be completed. Only those areas on the 3324 which have changed since the previous 3324 need be completed. Distribution will be as instructed on the form.

NCUA 3009, Consumer Compliance Record of Action, will be completed for each major area of concern noted during the contact. The problems and corrective action will again be discussed with the appropriate officials/employees. If the desired corrective action will require formal action by the board of directors, a quorum of the board will be required for a joint conference at the conclusion of the exam.

At least one copy of NCUA 3009 will be left with officials. Since the Follow-up Examination Report will not be retyped in the regional office, it is important that it be both technically and grammatically correct as typed by the examiner.

All workpapers and examination notes completed during the follow-up examination will be attached to the Follow-up Examination Report and submitted to the regional office.

COMPLAINT INVESTIGATIONS

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COMPLAINT INVESTIGATIONS

CI. GENERAL

NCUA receives hundreds of complaint letters each year from credit union members who have problems with their credit unions. Many of these complaints are assigned to examiners to investigate. This section covers the procedures to be followed when assigned to conduct one of these investigations.

CI.1 BACKGROUND

NCUA policy is to investigate and respond to each written complaint received. This policy involves the following considerations:

a. Many of the complaints allege violations of laws or regulations which NCUA enforces. The investigation of these complaints is an integral part of NCUA's enforcement program.

b. For those complaints that are not covered by laws or regulations, many of them indicate FCU operational problems. It is part of NCUA's supervisory function to investigate operational problems and recommend that they be corrected.

c. Some complaints, although not covered by any existing law or regulation, will illustrate questionable practices that NCUA will want to address. It is primarily through the investigation of member complaints that such practices are brought to light.

d. It is NCUA's objective to be responsive to the public and to credit union members who have legitimate problems with their credit unions, whenever possible.

e. It is NCUA's intent to accomplish the above objectives without taking an adversarial position with respect to the credit unions involved.

CI.2 NCUA COMPLAINT HANDLING PROCEDURES

Complaints are handled by the regional office Consumer Affairs staff. (Complaint letters received by the Washington Office are forwarded to the appropriate regional office for handling.) The regional office will acknowledge each written complaint in writing, have it investigated and send a final response letter to the complainant. The goal of the agency to handle each complaint within 45 days from receipt in the regional office.

Many complaints are investigated by regional office staff by telephone or by requesting a report from the FCU. Some complaints, particularly those that involve account discrepancies, are referred to the supervisory committee for investigation. The supervisory committee investigates the complaint and sends the regional office a report. The regional office sends the member a final response letter. A copy of all regional office complaint correspondence will be forwarded to the appropriate consumer examiner, who will maintain the material in the field file for future reference.

In some instances complaints involving violations of consumer laws will trigger priority examinations rather than separate complaint investigation contacts. (Refer to section CCE 1.2 - Scheduling Consumer Compliance Examinations.) When this is the case, the Chief of Consumer Affairs will so instruct the examiner. There will be instances, however, when complaint investigation contacts will be made. This section deals with those contacts and related procedures which may also be applicable during a examination, such as the expanded loan profile to detect ECOA discrimination.

Certain types of complaints are sent to the examiner for an on-site ivestigation. These are usually complaints that allege violations of consumer laws or regulations, complaints that the FCU officials failed to resolve, or other complaints of special interest to the regional office or Washington office. In these cases, the regional office will send the consumer examiner a copy of the complaint letter along with general instructions on what to do. For difficult or unusual complaints, specific suggestions or guidelines on what the issues are, what points to cover and how best to investigate the complaint will be provided.

Normally, the examiner will be instructed to proceed with the investigation within a short period of time. This may result in some disruption to the examination schedule. Occasionally, however, for complaints that do not have priority, the examiner may be instructed to investigate the complaint during the next regularly scheduled consumer compliance examination.

Almost all examiner investigations will require an on-site contact at the FCU in order to examine FCU records and properly interview the FCU officials and employees. The examiner will conduct the investigation and forward a report to the regional office. Based on the examiner's report, the regional office will prepare a final response letter to the member outlining the results of the investigation. It is also NCUA's policy that all violations directly related to the complaint will be disclosed to the member in the response letter.

The examiner may provide a copy of the complaint letter to appropriate FCU officials during the investigation, unless the complainant specifically requests conficentiality.

Occasionally, the examiner may receive a complaint letter directly from a member. These should immediately be forwarded to the regional office for handling. An exception to this is where, during the examination, the examiner is approached by a member who has a complaint that alleges a violation of a consumer law or regulation. In this case, the examiner should investigate the complaint as part of the examination. The examiner must file an investigation report on the complaint and document the action in the examination report.

CI.3 OBJECTIVES OF THE INVESTIGATION

The examiner's objectives in investigating the complaint are:

a. to determine and evaluate the facts;

b. to determine if the FCU violated any law or regulation, including violations of state law as covered in section 5;

c. to determine if the FCU treated the member unfairly;

d. to arrange for corrective action where required; and

e. to provide the regional office with enough information to respond to the complainant.

Although the objectives of the complaint investigation are somewhat similar to those of the examination, the examiner's role will be somewhat different. The complaint investigation usually deals with a particular event or transaction, and the examiner will have to determine the facts (to the extent possible) and whether there were any violations. (Does the complainant's disclosure statement comply with Regulation Z? Did the FCU violate Regulation B in denying the loan application?) If there are violations, the examiner will require corrective action. The corrective action may involve a settlement of the particular complaint by making reimbursement for an underdisclosure or reconsidering a loan application, for example.

If the investigation reveals that the FCU engaged in one of the questionable practices covered by the Special Recommendations section of the Guide, the examiner will make the appropriate recommendation.

If the questionable practice caused the particular complaint, or had a direct impact on it, the examiner will recommend that the FCU officials resolve the complaint.

The examiner should recommend specific steps the officials can take to settle the complaint. However, the examiner should not attempt to be an arbitrator or a judge, such as deciding which party is telling the truth.

The examiner must be sure to clearly distinguish, in a way the FCU officials understand, between action required to correct violations and recommendations that are voluntary on the part of the FCU to deal with questionable practices.

CI.4 GENERAL PROCEDURES

The general steps to follow when investigating a complaint are as follows. (These are not necessarily in order.)

a. Read the complaint letter. Briefly outline the areas of complaint and questions asked by the complainant.

b. Determine the appropriate type of investigation.

c. Interview the complainant, if possible.

d. Telephone FCU official/employee and prearrange the investigation contact.

e. Review the complainant's credit union file.

f. Review pertinent written credit union policies.

g. Review pertinent credit union procedures.

h. Interview appropriate credit union officials and/or employees.

i. Perform a loan review if necessary.

j. Determine validity of complaint.

k. Develop plans for corrective action if needed, or make appropriate recommendations.

l. Have corrective action implemented or obtain agreements from appropriate credit union officials and/or employees.

m. Prepare and submit the investigation report.

The complainant will normally be contacted during the investigation unless the complaint letter is self-sufficient. Although a personal interview is preferable, contact may be made by telephone to obtain a complete understanding of the problem and to verify the areas of complaint and questions asked, if any. During the discussion with the complainant, the examiner should be careful not to express an opinion as to the probable validity of the complaint. The examiner should conduct all discussions/interviews in a courteous and businesslike manner and should convey a sincere regard for the concerns of the complainant. In those cases where there was no contact with the complainant, the reason why will be discussed in the investigation report.

In addition to determining whether there is a violation in the complainant's particular situation, the examiner will determine what the FCU's general practices are in the area complained about. (Is the credit union complying with the law or regulation in general?) If the credit union is not complying, the examiner should try to determine if any other members have been adversely affected by the practice. This may be the basis for corrective action.

The examiner should keep in mind that there is often a difference between stated policy and actual practice. The examiner should not rely on statements of policy or procedure. Rather, it is the examiner's responsibility to determine from records and interviews what the actual practice of the FCU is. The FCU manager should not be relied upon to do the investigation for the examiner. All information should be obtained first-hand, if possible. Similarly, the examiner should actively try to determine what actually happened rather than merely report various versions of what happened. (An exception would be when there is a factual dispute that is impossible to resolve.)

The examiner should not initiate a joint meeting between the complainant and FCU officials as a means of resolving disputes or expediting the investigation. This is often counter-productive and may be intimidating to the complainant. (An exception would be where both parties request such a meeting.)

Interviews with any of the parties involved should be conducted in private if possible. The examiner should identify himself or herself as an NCUA examiner, tell the person that he or she is investigating a complaint and ask the person's permission to be interviewed. All interviews with complainants are voluntary. If the complainant wants another person persent during the interview, this request should be granted. If the complainant does not wish to be interviewed, the examiner will honor the request. However, the examiner will inform the complainant that lack of an interview could affect the examiner's ability to conduct the investigation.

The consumer examiner should comply with an FCU's request to contact its attorney, or to let the attorney be present during an interview with an FCU official or employee. If an FCU refuses to make its officials or employees available for interviews, the examiner will contact the Chief of Consumer Affairs immediately. Appropriate action will be discussed and determined.

The examiner should take notes during the interview. If the interviewee says something that is crucial to the case, the notes should be especially clear. In such instances, if possible, the interviewee's exact statements should be noted verbatim, and put in quotation marks. (In administrative hearings, these notes are very important. The examiner may be called upon to testify and his or her testimony would be based on the notes. The examiner may be cross-examined about the accuracy of the notes.) Affidavits or tape recordings should not be used.

No one likes to be investigated. Credit union officials and employees will often be defensive. Complainants also may be antogonistic. The examiner will have to be very skillful and tactful in obtaining the necessary information without alienating people.

Often, the examiner will find himself or herself in the middle of a dispute between the member and the FCU. The examiner must be completely impartial and should never give the appearance of favoring one side over the other or having already made his or her mind up before the investigation is completed.

The examiner should always keep an open mind. Some statements made in the complaint letter may turn out to be erroneous. But this does not necessarily disprove the entire complaint. Remember, the complainant usually knows very little about the internal operations of the credit union and often knows very little about standards of creditworthiness, for example. All he or she may know is what happened in the situation giving rise to the complaint.

Investigation procedures for specific types of complaints are discussed in the next few sections.

CI.5 TRUTH IN LENDING COMPLAINTS

For complaints that allege improper TiL disclosures, the examiner will review the disclosure statement for TiL violations and verify the finance charge and APR. If there is an underdisclosure, the examiner will require the FCU to make an adjustment to the debt or a reimbursement to the complainant, as appropriate.

The examiner will follow appropriate procedures to determine why the violation occurred, and whether there is a pattern. If a pattern exists, the consumer examiner will seek guidance from the Chief of Consumer Affiars.

There is usually no need to interview the complainant in these cases unless there are factual disputes that must be resolved in order to make a determination on the case.

CI.6 ECOA DISCRIMINATION COMPLAINTS

These complaints are probably the most difficult and time-consuming to investigate. The investigations are very important, though, because they are one of the most effective means we have of monitoring FCU compliance with ECOA.

The investigation will consist of three basic steps:

a. Fact-finding about the complaint.

b. A review of the FCU's loan policies.

c. A special loan sample.

When necessary, an expanded sample will be completed.

The examiner will take exception to all violations noted during the investigation. The examiner will pay especially close attention to application forms and adverse action notices. (See also Section CI.10 of this Guide for handling unrelated violations.)

The examiner will never automatically assume that there is no discrimination solely because the credit union provided a valid reason for rejecting the application.

If the application is rejected (or not granted in the amount and terms requested) because of adverse credit information contained in a credit report obtained from outside sources, the examiner will ensure that the credit union's procedures in this area are not being applied on a prohibited basis. For example, if credit reports are not being obtained on all loan applicants, the examiner must determine whether more credit reports are being obtained on applicants of a certain race, sex, marital status or age. If discriminatory procedures for obtaining such outside credit reports are proven or suspected, the examiner will have the FCU establish specific, written, and non-discriminatory procedures or have the FCU adopt procedures to obtain outside credit information on all loan applicants. The written procedures should allow the credit committee discretion to obtain outside credit information whenever the committee members believe such is necessary in addition to any unusual case in which such a report would be ordered. When exercising this discretion, the credit committee should state in writing (in the credit committee minutes or in the member's loan file) why the outside credit information was considered necessary.

If not previously provided, the examiner may ask the complainant to provide, if possible, the names of: (a) other members who feel they have been disciminated against, and (b) other members of a different race, sex, etc., who may have been treated more favorable. (The complainant may not be willing to provide this information for reasons of privacy.) Loan documents pertaining to these other members will be included in the special loan sample.

Consideration must also be given to the "effects test". See section 21.2 of this Guide.

a. The investigation should include the following steps (not necessarily in this order):

CI.7 DEBT COLLECTION COMPLAINTS

The objective of the investigation is to determine if the FCU handled the member's account in conformance with the principles of the Fair Debt Collection Practices Act.

The investigation will usually consist primarily of fact finding. (Did the FCU call the member at 7:00 AM on August 29? Did the collector use profanity?) The investigation may also involve reference to the loan agreement or other documents. (Did the FCU charge the member collection costs not authorized in the agreement?)

The examiner should interview the complainant for further details, and interview any FCU collectors involved in the complaint. The examiner should review any notations the collector may have or any other records relating to the member's account. If there is a dispute about what was actually said or done (which is often the case), the examiner should attempt to resolve the dispute through follow-up questions or interviews if it is important to the case. (The examiner should recognize, however, that it is often not possible to resolve such factual disputes.)

If the FCU was covered by the Fair Debt Collection Practices Act for the debt complained about, the examiner will treat any nonconformance as a violation and require corrective action.

If the FCU was not covered by the Fair Debt Collection Practices Act, any non-conformance will be handled as a questionable practice in accordance with section 20 of this Guide.

CI.8 REPOSSESSION COMPLAINTS

The first thing to determine in investigating a repossession complaint is whether the repossession was legal. Two major considerations are whether the FCU has a valid security interest in the collateral and whether the member was actually in default at the time the collateral was repossessed. ("Default" will usually be defined in the note or security agreement.)

Aside from these two considerations, there are certain other technical matters that should be checked. The examiner should determine whether the security interest was properly disclosed under Truth in Lending, whether the member received a copy of the disclosure statement, whether the lien was properly recorded, and whether the FCU followed state law governing notification before or after the repossession. These technical matters will not usually render the repossession itself illegal.

If the repossession was legal, the examiner will try to determine if it was done fairly or reasonably in accordance with generally accepted business standards. If it was not, the examiner should recommend that the FCU resolve the complaint in a satisfactory manner.

CI.9 CONFIDENTIALITY

Confidentiality or anonymity, to the extent permitted by law, will be granted to the complainant if requested. When such treatment is requested, the examiner may remind the complainant that the investigation may be hindered and may explain that under normal circumstances information relevant to the complaint is only discussed with FCU officials and employees on a a need-to-know basis. However, the examiner will not pressure the complainant to withdraw the request for anonymity.

During the investigation, the examiner will discuss the complaint or disclose information provided by the complainant or obtained during the investigation only to the extent necessary to adequately investigate the complaint. (This includes the fact that the complainant filed a complaint.) When investigating the complaint, the examiner will remind the FCU officials and employees of the confidentiality requirements of Article XIX, section 2 of the FCU Bylaws. If more than one complainant is involved, information about one complainant will not be relayed to the other complainant.

Ocass[illegible], a third party such as an attorney, a Congressperson or a civil rights org[illegible]zation may file the complaint on behalf of the complainant.

The investigation may be discussed with these third parties if they are clearly acting as the complainant's authorized representative. Otherwise, the examiner will obtain the written consent of the complainant before discussing the investigation with any outside parties.

The examiner should remember that the investigation report and all related documents and correspondence are covered by the Privacy Act of 1974 (see Subpart B of Part 720 of the NCUA Rules and Regulations). The complainant can usually get a copy of the report by filing a Privacy Act request. Similarly, the FCU can usually get a copy of it by filing a Freedom of Information Act request.

With respect to the Right to Financial Privacy Act of 1978, an investigation of a complaint is similar to a supervisory examination and thus the notice requirements of the Act do not apply. Therefore, a examiner can review the records of FCU members without notifying the members or certifying to the FCU that NCUA is complying with the Act. (The Right to Financial Privacy Act could possibly be involved, however, if NCUA refers information obtained during the investigation to another regulatory or law enforcement authority.)

CI.10 UNRELATED VIOLATIONS

Violations or questionable practices discovered during the investigation which do not relate to the complaint will not be overlooked. Such violations will generally be noted during the review of the complainant's file and the loan review, if performed. The examiner is expected to detect all violations which would normally be noted by following the investigation procedures. For example, if the complainant's loan file is reviewed, an incorrect loan form (application, disclosure, adverse action notice) should be noted. Unrelated violations will be handled the same as related violations in that corrective action will be required. Unrelated violations will not be discussed with the complainant and will only be reflected in the "INTERNAL NCUA INFORMATION/COMMENTS" portion of the investigation report. (Unrelated violations may be disclosed to the complainant in the regional office's final response letter.)

CI.11 THE INVESTIGATION REPORT

The examiner will report on the investigation by memo to the Chief of Consumer Affairs or Regional Director, as appropriate. The investigation report will be submitted to the regional office within two working days after completing the investigation.

When writing the investigation report, the examiner discuss whom he or she interviewed and what loan sample methodology was used. A copy of the loan profile will be submitted with the report. A copy of the complainant's loan application, adverse action notice, and any other pertinent documents will also be attached.

CI.12 FOLLOW-UP

When possible, the investigation will be performed in such a manner that later follow-up by NCUA will not be necessary. When corrective action is needed and it is possible to do so, it should be completed by officials or employees during the investigation. Also, where needed and feasible (considering time and travel costs), the time period of the investigation may be expanded to allow for full correction of any noted problems and violations. In those cases when a corrective action cannot be completed during the investigation, agreements will be reached with the officials. In such cases, an agreement will be obtained for the FCU to notify the Regional Director upon completion of the corrective action.

CI.13 REGIONAL OFFICE APPRAISAL

The regional office will review and evaluate the investigation by completing a "Complaint Investigation Appraisal" form and forwarding it to the examiner.

CI.14 REFERENCES/STUDY GUIDES

NCUA Instruction No. 4000.6: Complaint Handling Procedure

ADMINISTRATIVE ACTIONS

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ADMINISTRATIVE ACTIONS

AA1 GENERAL POLICY

There are several administrative remedies available for the NCUA Board's use in supervising Federal credit unions. The types of administrative actions are discussed in this section of the Consumer Examiner's Guide.

The use of administrative action is not a punitive measure but an action designed to attain certain objectives. The action should be recommended by the consumer examiner as the alternative course of action only after all other supervisory efforts have failed to obtain satisfactory results and when the action will lead to compliance with the provisions of the charter, Federal Credit Union Act, Bylaws, Rules and Regulations, and consumer laws and regulations.

Administrative action should not be discussed with the officials until the consumer examiner has received clearance from the Chief of Consumer Affairs. An exception to this general rule would be when a credit union has in its possession a preliminary warning letter from the regional director citing existing deficiencies and expressing the possibility of administrative action. In all cases, the consumer examiner should consult with the Chief of Consumer Affairs before submitting a recommendation for administrative action. The Closed Section of the examination report or follow-up examination report will state whether the Chief of Consumer Affairs concurred with the recommendation.

All facts and circumstances surrounding the particular violation of the charter, Act, Bylaws, Rules and Regulations, or consumer law or regulation must be thoroughly examined to determine what action is most appropriate. Some of the relevant considerations would be (a) the interest exhibited by management in the proper operation of the credit union; (b) the ability of management to effectively carry on the operation; (c) the ability of the credit union to handle any financial impact; and (d) the interest of the membership.

The NCUA Board, however, would not be precluded from withdrawing a particular action and filing another, should the facts as they develop necessitate the cessation of the original proceeding and the institution of a new course of administrative action.

AAI.1 CONSUMER EXAMINER'S ROLE IN ADMINISTRATIVE ACTION

The consumer examiner plays a key role in administrative actions in that he or she represents NCUA for the credit unions in his or her district. The consumer examiner is on the scene and must be aware when conditions at a credit union are such that administrative action is necessary in NCUA's supervision of the credit union. Additionally, it is possible that the consumer examiner will be called upon to testify at any hearing held, and that his or her records will likely be used as evidence.

It is important that the consumer examiner take a positive and practical approach in dealing with problems. The consumer examiner's major function is to convince the officials of the need for carrying out the recommendations and plans of action he or she has developed with them. The consumer examiner's recommendation must be logical and practical and based on facts and realistic projections.

Each consumer examiner must know the different types of administrative action that are available, the grounds for taking an action, and the objectives of the action. Administrative action is a serious matter and a costly process for NCUA and the credit union. Therefore, it is important that the consumer examiner utilize all other supervisory procedures and efforts before recommending administrative action.

AA1.2 RECOMMENDATION FOR ADMINISTRATIVE ACTION

AA1.3 PRELIMINARY WARNING LETTER

As a preliminary step to administrative action, the credit union will, as a standard practice, be forewarned by letter from the regional director that unless the persisting serious problem is corrected, or reasonable progress is made toward the elimination of the problem, the regional director will recommend that the NCUA Board seek correction through administrative action.

This warning, either in a separate letter or as a part of the examination report transmittal letter, may be sufficient to motivate the officials to take necessary corrective action. The consumer examiner's analysis and evaluation of a case to determine whether a preliminary warning letter should be recommended shall be of sufficient depth to justify administrative action should the credit union fail to correct the conditions cited in the warning letter.

AA1.4 CEASE AND DESIST

Pursuant to Section 206 of the Federal Credit Union Act, the NCUA Board is empowered to issue a notice of charges to a credit union for reasons constituting an alleged unsafe or unsound practice or violation of the Federal Credit Union Act, NCUA Rules and Regulations, any applicable law or regulation, any condition imposed by the NCUA Board, or any agreement entered into with the NCUA Board. This is the type of administrative action which will usually be recommended by the examiner.

The unique feature of this administrative remedy is that it allows for anticipatory action by the NCUA Board. Thus, not only can the Board act to prevent a recurrence of, and correct the resulting conditions of, an unsafe or unsound practice or a violation of the Act, Rules and Regulations, any relevant condition imposed in writing by the Board, or any agreement entered into with the Board, but it can also, if it has reasonable expectations based on facts developed by the consumer examiner, proceed in anticipation of the credit union's action. Hopefully, the Board can thereby prevent occurrence of those acts which could lead to the issuance of an order either suspending the credit union's charter or removing its officials.

A cease and desist action is a means by which the Board can take strong affirmative action against the credit union and at the same time avoid weakening its operational and managerial integrity, which can result from other types of administrative action.

The issuance of a cease and desist order should be sufficient impetus to compel the credit union to take the desired action. If, however, the consumer examiner believes that compliance would not be effectuated by issuance of such an order, an alternative administrative remedy (such as those discussed in subsections .5 and .6) should be seriously considered.

When the consumer examiner encounters a credit union with persisting problems, and previous consumer compliance examination and follow-up examination reports contain sufficient information to show that the present officials have had adequate time to resolve the problem, he or she must reappraise the entire situation. An analysis of why the problem has not been corrected will need to be made. In addition to objectively evaluating the previous actions of management in dealing with the problem, the consumer examiner will also need to assess his or her (and previous examiners') efforts in attempting to assist the officials in eliminating the problem.

The cease and desist action will be, in most cases, the most appropriate type of administrative remedy in dealing with the persistent serious problem syndrome. It should have sufficient force to motivate the officials to take corrective action to eliminate the deficiencies causing the action or to resign so that others more qualified and/or responsive will be able to serve. The consumer examiner will consult with the Chief of Consumer Affairs before submitting a recommendation for cease and desist action against any credit union.

A persistent serious problem is defined as any major area of concern that:

a. Is a serious violation of the charter, Act, Bylaws, Rules and Regulations, any applicable consumer laws or regulation or any condition or agreement imposed by the NCUA Board, and

b. Has been adequately reported in the open section of the previous consumer compliance examination or follow-up examination report released to the officials, and

c. Is a practice or condition that can be resolved by one or more officials who presently are unresponsive or unwilling to take the necessary steps to effect correction.

Recommendations for cease and desist action will not necessarily be confined to a persisting problem. If a serious problem disclosed for the first time could have a significant adverse impact on the credit union's operations, and the officials have indicated they will not effect corrective action, a cease and desist action may be the appropriate remedy. However, such a recommendation will not be made without concurrence from the Chief of Consumer Affairs.

The cease and desist action is usually a three step process. The steps are:

a. Preliminary Warning Letter (refer to section AA1.3.)

b. Notice of Charges and Hearing

The Notice of Charges and Hearing will contain a statement of fact constituting the alleged unsafe or unsound practice or violation or anticipated action. The notice will fix a time and place at which a hearing is to be held to determine whether an order to cease and desist therefrom (the charges in the notice) should be issued against the credit union. The date for hearing will not be earlier than 30 days, nor later than 60 days, after service of notice unless an earlier date has been set by the NCUA Board at the request of the credit union. The consumer examiner should caution the credit union as to the seriousness of the notice upon its delivery to the credit union. The officials should also be made aware of the time frame in which they must respond to the Board in answer to the allegations, and that the credit union or its representative must file a written notice of appearance with the Administrative Law Judge. These instructions will be included in the notice.

c. Cease and Desist Order

(1) Permanent

If the credit union consents to the issuance of the Cease and Desist Order, or if the NCUA Board finds at the hearing, or through its review of the hearing record, that the unsafe or unsound practice or violation or anticipated action specified in the Notice of Charges and Hearing has been established, it may issue and serve upon the credit union an order to cease and desist from any such practice or violation or anticipated action.

A Cease and Desist Order becomes effective at the expiration of 30 days after service of such order upon the credit union concerned and it remains effective and enforceable, except to the extent as it is stayed, modified, terminated or set aside by action of the NCUA Board or reviewing court. A Cease and Desist Order issued upon consent becomes effective at the time specified in the order.

(2) Temporary

If the Board determines that the facts as presented by the consumer examiner and the regional director and as written into the Notice of Charges and Hearing are likely to cause insolvency or a substantial dissipation of credit union assets or earnings, seriously weaken the condition of the credit union or otherwise seriously prejudice the interests of its members, a Temporary Cease and Desist Order may be issued.

The Notice of Charges and Hearing will precede or accompany the Temporary Cease and Desist Order. The Temporary Cease and Desist Order becomes effective when served on the FCU and remains effective unless set aside, limited or suspended by a court in proceedings (authorized under Section 206(f)(2) of the Act and Section 747.306 of the Rules and Regulations) in which the credit union applies for injunctive relief. Otherwise it remains effective pending completion of the administrative proceedings held on the date specified in the Notice of Charges and Hearing and/or until such time as the NCUA Board dismisses the charges. In the case when a Cease and Desist Order (Permanent) is issued against the credit union, the temporary order continues until the effective date of the permanent order.

AA1.5 SUSPENSION AND REMOVAL OF DIRECTORS, OFFICERS, AND/OR COMMITTEE MEMBERS

The administrative action to suspend and remove directors, officers or committee members is available as an initial course of action, or as a continuation of a Cease and Desist Order if the officials refuse to comply as directed. Whether the action is recommended as an initial course of action or a continuation of a Cease and Desist Order, it is a separate form of action and has its own applicability to particular situations. In rare cases this administrative remedy may be recommended by the consumer examiner. As with other such remedies, prior concurrence by the Chief of Consumer Affairs is required.

Under Section 206(g)(1) of the FCU Act, the action to remove any director, officer or committee member must be supported by (a) a violation of a law, rule, or regulation, or of a Cease and Desist Order which has become final, (b) the official's participation in any unsafe or unsound practice in connection with the credit union, or (c) has the official's commission or involvement in any act, omission, or practice which constitutes a breach of fiduciary duty. To remove an official under this section, the Board must determine that substantial loss or other damage has or will probably occur or that the interest of the credit union's NCUSIF insured members could be seriously prejudiced if loss or damage has not yet occurred.

Under Section 206(g)(2) of the Act, removal and prohibition action against any director, officer, or committee member must involve personal dishonesty or unfitness in the conduct or practice with respect to another insured credit union or other business institution which resulted in substantial financial loss or other damage to the FCU. Substantial financial loss or other damage must have occurred in order to support action under this section. Any other person may also be prohibited from further participation in the conduct of the affairs of a credit union insured by the NCSIF. If this person's participation in the conduct of the affairs of a NCUSIF insured credit union resulted in substantial financial loss or other damage to that credit union, it must be evidenced by his or her personal dishonesty or unfitness.

In many cases involving dishonesty or unfitness on the part of a director or officer or committee member, suspension and removal of the person will usually become an internal matter and will be accomplished by the board of directors. Sometimes the dishonest or unfit director, officer or committee member will voluntarily resign. Such situations will usually occur when investigations by credit union officials disclose certain persons to be apparently responsible.

[redacted]

A recommendation by the consumer examiner for suspension and removal of a director, officer or committee member will be prepared in the same manner as other administrative action discussed in the Guide. However, the consumer examiner will need to include in support of the recommendation: (a) the name and title of the person recommended to be suspended and removed; (b) sufficient evidence supporting the allegation, violation, practice, or breach of fiduciary duty (under Section 206(g)(1) of the Act), or conduct or practice with respect to another NCUSIF insured credit union or other business institution which resulted in substantial financial loss or other damage involving personal dishonesty and/or unfitness (under Section 206(g)(2) of the Act); and (c) how the credit union has suffered or will probably suffer substantial financial loss or other damages or that the interest of its NCUSIF insured members could be seriously prejudiced (under Section 206(g)(1) of the Act), or how this act has resulted in substantial financial loss or other damages (under Section 206(g)(2) of the Act).

Removal of a director or officer or committee member can not be done in anticipation of a problem occurring. It can be used only when an official has committed the act which constitutes grounds for his removal. Removal can take place only after a notice of intent to remove or a notice of suspension has been issued and the appropriate administrative proceeding has been held, as provided in the NCUA Rules and Regulations. (Section 206(g)(3) of the FCU Act does permit suspension upon service of the notice, if necessary to protect the interests of credit union members.

a. Notice of Intent to Remove an Official From Office and Notice of Intent to Prohibit a Person From Further Participation in any Manner in the Conduct of the Affairs of the Credit Union:

The action to remove officials, or prohibit other persons from further participation in the conduct of the affairs of the credit union will be considered when an official's or any other person's individual action is deemed to be detrimental to the credit union or to the interests of its members, or to create a potential loss to the NCUSIF. Under Section 206(g)(1) of the Act, a Notice of Intent to Remove an Official From Office will be based on grounds that the director, officer, or committee member committed any violation of a law, rule, or regulation, or of a Cease and Desist Order which became final, or engaged or participated in any unsafe or unsound practice, or committed or engaged in any act, omission, or practice which constitutes a breach of fiduciary duty. It must be determined with reasonable certainty that the credit union has suffered or will suffer substantial financial loss or other damage or that the interests of its members could be seriously prejudiced by reason of such violation, or practice, or breach of fiduciary duty.

Under Section 206(g)(2) of the Act, a Notice of Intent to Remove an Official From Office and/or Prohibit a Person From Further Participation in any Manner in the Conduct of the Affairs of the Credit Union will be based on grounds that the official or person participating in the conduct of the affairs of an insured credit union, by conduct or practice with respect to such credit union, or other insured credit union, or business institution, caused substantial financial loss or other damage. Such action must be sufficient to evidence his personal dishonesty or unfitness to continue to participate in the conduct of the affairs of such insured credit union.

The Notices, whether to remove an official from office or prohibit a person from further participation, will contain a statement of facts constituting the grounds for the action and fix a time and place at which a hearing will be held. Normally, the hearing is fixed for a date not earlier than 30 days nor later than 60 days after the date of service of such notice.

The rules of practice and procedure contained in subparts A and E of Part 747 of the Rules and Regulations are applicable to suspension and removal orders. The examiner should inform the official or other person upon delivery of the notice that unless such director, officer, committee member, or other person files an answer to the charges and appears at the hearing in person or is represented by a duly authorized representative, he or she will be deemed to have consented to the issuance of an order or prohibition.

b. Suspension of an Official From Office and Prohibition of any Manner in the Conduct of the Affairs of the Credit Union

An immediate suspension of an official or prohibition of any person may be recommended by the consumer examiner if the time frame established for hearing will result in further erosion of the credit union's assets caused by the actions of the official or other person to be named in the notice or is necessary to protect the interests of the credit union or its members. Such action is similar in effect to the immediate suspension of charter except that in these cases the official or other person will be suspended or prohibited from further participation in the affairs of the credit union rather than suspending the operations of the credit union. Such a suspension becomes effective upon service of an order, and, unless stayed by a court in proceedings authorized in Section 206(g)(5) of the Act, remains in effect pending the completion of the administrative proceedings.

c. Suspension and Removal Where Felony is Involved

The consumer examiner will be alert to any reported complaints authorized by a U.S. Attorney brought against any director, officer, committee member or other person participating in the conduct of the affairs of an insured credit union, or any information or indictment, involving the commission of or participation in a crime involving dishonesty or breach of trust by such persons, where such crime is punishable by imprisonment for more than one year.

The consumer examiner will report any available evidence in such cases directly to the Chief of Consumer Affairs. In no instance should the consumer examiner proceed to investigate any complaints or indictments brought against officials or other persons participating in the conduct of a credit union's affairs without first consulting with the Chief of Consumer Affairs.

If the U.S. Attorney, or enforcement agency, verifies in writing or provides other competent written evidence that an official or other person has been charged in a felony involving dishonesty or breach of trust, the consumer examiner will report the findings in support of a recommendation to suspend the official or prohibit the person from further participation in any manner in the conduct of the affairs of the credit union.

The suspension or prohibition order will usually cite only the statement that the person has been indicted or a complaint has been filed by the U.S. Attorney, or enforcement agency, and will not in any way state or allude to innocence or guilt. The consumer examiner will also refrain from expressing an opinion on guilt or innocence in the recommendation for suspension or prohibition. The suspension or prohibition remains in effect until the information, indictment, or complaint is finally disposed of and until terminated by the NCUA Board.

If a final verdict of guilty is reached, and at such time as the judgment is not subject to further appellate review, the Board may issue and have the examiner serve upon the person an order removing him or her from office or prohibiting further participation in the conduct of affairs of the credit union.

The consumer examiner will maintain close follow-up on the proceedings and immediately report any new developments which may affect the order issued or pending to the Chief of Consumer Affairs.

AA1.6 SUSPENSION OF CHARTER

Section 120(b)(1) of the Federal Credit Union Act empowers the Chairman of the NCUA Board to suspend the charter of a Federal credit union that is bankrupt or insolvent, has violated any provisions of its charter, its bylaws, the Act, or any regulation. Obviously, the ultimate effect of this form of administrative action is the elimination of the credit union as a legal entity, and therefore, it is the most drastic administrative remedy that can be exercised, particularly from the members' viewpoint. This remedy will only be taken when a credit union is insolvent and/or has committed the most serious and irreversible violations of any provisions of its charter, its bylaws, the Act, or any law or regulation. Conditions in an operating credit union that would warrant a recommendation for suspension of charter are:

a. Insolvency, as defined in 700.0(k) of the NCUA Rules and Regulations.

b. Abandonment of the credit union's operations and affairs by the elected and appointed officials.

c. Plant closing and officials refusing to vote to present the question of liquidation to the members, if such refusal may cause a dissipation of the assets and expose the creditors and the NCUSIF to a greater than normal risk.

d. Other specific serious violations of the charter, Bylaws, Act, or regulations that cannot be reversed and that are causing or will cause an insolvent condition.

Because of the significant impact suspension of charter will have on the membership and the credit union system as a whole, the consumer examiner should make certain that the bases for his or her recommendation are indisputable and represent the most logical solution to the credit union's problems. For this reason, suspension actions will not be initiated without current information about the credit union in the form of a recent consumer compliance examination or follow-up examination report with the appropriate supporting workpapers.

This administrative remedy will seldom, if ever, be used for violations of consumer laws or regulations. Concurrence of the Chief of Consumer Affairs will be obtained prior to making such a recommendation.

AA1.7 DELIVERY OF NOTICE OR ORDER TO THE CREDIT UNION

The consumer examiner will usually be assigned to deliver the notice or order to the credit union. He or she shall obtain a signed receipt (form provided by Washington office or typed on copies of administrative action) from the person(s) who accepts delivery. The consumer examiner will give the highest priority to the delivery of administrative actions. In unusual cases when the notice or order is mailed directly to the credit union, the consumer examiner will receive a copy from the regional office.

The consumer examiner will recieve instuctions through the Chief of Consumer Affairs from the regional director concerning when he or she is to make delivery of administrative actions. These instructions will usually include: (a) The name of the credit union officer to whom the delivery will be made; (b) Instructions as to whether a joint conference should be called for the purpose of delivering the action; (c) Specific matters to be covered at the joint conference if one is to be held; and (d) Supervision plans to be followed while the action is in effect.

Refusal by the credit union officials to accept the administrative action will not alter its force and effect. Should such a situation arise, the consumer examiner shall deposit uhe original of the administrative action in a conspicuous place designated as the credit union's place of operation in view of at least one official. Such an unorthodox delivery, or inability to effect delivery, shall be promptly reported to the Chief of Consumer Affairs. If the administrative action includes an Appointment of Agent for the NCUA Board and the officials refuse to release the records, this fact should also be promptly reported to the Chief of Consumer Affairs. The Chief of Consumer Affairs, with concurrence from the regional director, will immediately arrange for assistance from a U.S. Marshall through the Department of Justice, Office of the U.S. Attorney to take possession of the records. The consumer examiner should be familiar with the rules and procedures applicable to suspension of charter, involuntary liquidation and all hearings as provided in Part 747 of the NCUA Rules and Regulations and General Counsel, and provide the credit union being served with an administrative action general guidance as to the credit union's options and the time frame for responses. However, under no circumstances should the consumer examiner become involved in a discussion with the officials on matters that require legal interpretation of rights and alternatives.

AA1.8 SUPERVISION OF CREDIT UNION AFTER DELIVERY OF ADMINISTRATIVE ACTION

The Chief of Consumer Affairs, with instructions from the regional director, will give specific guidance to the consumer examiner regarding the supervision to be given the credit union after administrative action has been delivered. Frequently, these instructions will be the same as the examiner has stated in his or her memorandum or report recommending administrative action. In all cases, the supervision plan assigned will be directly related to the type of administrative action served on the credit union and the time frame for the credit union to exercise its right of due process as provided in the Rules and Regulations.

Frequently, additional facts relating to the administrative action will need to be developed for the NCUA Board's use in a hearing, or in its final decision on the remedy being sought in the administrative action. The highest priority should be given to these assignments. The consumer examiner will refrain from making statements during the follow-up examinations which could prejudice the case or place NCUA in an untenable or unsupportable position. In fact, the consumer examiner should say as little as possible except as otherwise provided in this section of the Guide.

AA1.9 ADMINISTRATIVE ACTION WORKPAPERS

SURETY BONDS

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SURETY BONDS

SB.1 PURPOSE OF SURETY BONDS

Suretyship is an old and complicated profession. Because of its complexities many people are frightened by the fine print and tend to rely upon hearsay to learn about the type of coverage offered by a surety bond. The purpose of this section of the Guide is to help the examiner become more familiar with suretyship in general and to help explain in a broad way the extent of the coverage, exclusions, conditions, and other terms of the surety bonds in effect in Federal credit unions. No attempt will be made to go into all of the ramifications of suretyship since volumes could be written on this subject. This discussion, however, is intended to stimulate the examiner's thinking so that when questions are raised regarding the terms of a surety bond, he or she will be able to go to the bond and carefully study all applicable portions. By so doing, he or she can be of tremendous assistance to credit union officials by helping them to understand what their surety bond is and how they can get the most benefit from it.

SB.2 DEVELOPMENT OF SURETY BONDS

Early surety bonds in Federal credit unions covered a specific individual who was named in the bond. A person elected, appointed, or hired to fill a position, which needed a bond, applied for a bond which would protect the credit union against losses caused by breaches of faithful performance including acts of dishonesty. In general terms, this was commonly known as an individual faithful performance bond.

To avoid the necessity of frequently changing bonds because of turnover of employees, a position schedule faithful performance bond was next developed by the Farm Credit Administration while it had responsibility for the supervision of Federal credit unions. In this bond, positions such as treasurer, assistant treasurer, collector, etc., were included in the schedule. The premium was based on the number of positions covered.

In cooperation with the Farm Credit Administration, the Surety Association of America later developed a Credit Union Blanket Bond, Standard Form No. 23. This bond covered a number of positions and is still in use today. It also broadened the coverage and introduced a number of insurance features.

In 1954, at the request of the Credit Union National Association, Congress amended the Federal Credit Union Act to require the Director of the Bureau of Federal Credit Unions to prescribe bond forms and to establish a schedule of minimum bond coverage to be carried by Federal credit unions. Prior to this time, the supervising agency issued a recommended minimum schedule of bond coverage which all credit unions were urged to meet.

Another type of Blanket bond coverage, Credit Union Blanket Bond - BFCU Optional Form No. 576, was approved by the Bureau in 1954. This form was developed with the cooperation of CUNA and the Bureau. Since 1954, other optional forms have been approved. With the change to separate agency status, the BFCU optional forms were redesignated NCUA optional forms.

SB.3 SURETY BOND REQUIREMENTS

Section 701.20 of the NCUA Rules and Regulations prescribes the form and minimum schedule of bond coverage. Also, under that section the Chairman of the National Credit Union Administration Board has the authority to require a Federal credit union to obtain additional coverage when, in his or her opinion, the coverages in force are not adequate. The board of directors is required under the regulations to provide adequate surety (and insurance) coverage. Adequate bond coverage to assure proper protection of the members' shares may require coverage in excess of the prescribed minimums. The directors should review the extent of coverage frequently, not less often than once every six months, and make a determination as to whether the coverage is adequate.

SB.4 FAITHFUL PERFORMANCE OF DUTY

Section 112 of the Federal Credit Union Act requires the treasurer to give bond conditioned upon the faithful performance of his or her trust. Section 701.20 of the NCUA Rules and Regulations expands this requirement to include any officer or employee while he or she is performing any of the duties of the treasurer as prescribed in the Federal Credit Union Act, the credit union's bylaws, or the rules and regulations of the National Credit Union Administration.

All surety bonds approved for use by Federal credit unions must contain a rider incorporating faithful performance of duty coverage as a part of the bond. The riders used with some of the NCUA optional form bonds extend faithful performance of duty coverage to employees and others, in addition to the treasurer. On the other hand, the rider used with some Standard Form No. 23 bonds extends faithful performance of duty coverage only to those employees, as defined in the bond, who are required by law or regulation to give bond for faithful performance of duties.

As with all matters dealing with surety bond coverage, the examiner is cautioned to read the applicable portions of the bond and its riders before taking a position on the coverages, exclusion, conditions, or other terms.

Although some surety company and credit union leaders have made the statement that "no one knows what faithful performance of duty means," courts fortunately have many times defined "faithful performance of duties." In one such decision, the court held that "a bond by a bank teller that he or she would faithfully perform the duties of his or her office should be construed to mean the use of reasonable and competent skill and ordinary diligence in the performance of his or her office, and is not limited to acting honestly only. It includes a faithful execution of the duties of his or her office, embracing competent skill and due diligence. The receiving of monies for which he or her has not accounted, if not justified or excused, amounts to a forfeiture of the bond."

Anyone accepting a position in a Federal credit union has the responsibility of protecting the members' savings by knowing the duties of his or her office and carrying out these duties in a diligent manner. If he or she fails to protect the property entrusted to his or her care, the surety may be held liable for any resulting loss. A faithful performance bond is breached when an employee commits a dishonest act. It may also be breached by negligent acts or omissions which are not necessarily dishonest in a criminal sense.

Since the question of whether a breach of faithful performance has occurred may arise during an examination or supervision contact, the examiner will sometimes be called upon to help the directors arrive at a decision as to whether to report a loss to the surety and/or file a claim. Such decisions must be made by the board of directors. The examiner should guide the directors so that the credit union's interests under the bond will be protected. If the directors disagree with the examiner's opinion that an act should be reported or that a loss has occurred and that notice of loss should be given to the surety, the Chief of Consumer Affairs should be promptly notified of all the facts. The regional director may decide, in unusual cases, to report the facts to the surety. A decision might also be made to recommend to the Washington office that administrative action be taken so that additional pressure is placed on the officials if a possible loss has occurred.

SB.5 CONSUMER LEGISLATION ENDORSEMENT

CUMIS Insurance Society, the most widely used surety company, offers an endorsement which may be added to the basic discovery bond to provide coverage in the consumer law and regulation area. This endorsement provides coverage for direct losss caused by noncompliance with various Federal and state consumer laws. The limits of liability for the rider and the deductible may differ from that provided in the basic discovery bond. CUMIS reserves the right to select the attorney who will defend a credit union in a Truth in Lending law suit. For specific coverages, liability limits and deductibles, the examiner should always refer to the endorsement and, if necessary, the surety bond.

SB.6 RIGHTS OF SALVAGE

The blanket discovery bond authorizes the surety to subrogate against the person responsible for the loss. However, this right is waived in the consumer legislation endorsement.

SB.7 TERMINATION OF THE BOND

The bond can be terminated in its entirety by written notice by the surety company or by the credit union. Some bonds are terminated in their entirety through the taking over of the credit union by a liquidator, receiver, the National Credit Union Administration, or any other concern. The bond is not terminated by a Federal credit union entering voluntary liquidation. It is terminated as it applies to any employee immediately upon the discovery by the credit union of any act of fraud or dishonesty committed by him or her. The surety company may also terminate the bond as it applies to any individual by giving notice to the credit union.

The CUMIS consumer legislation endorsement may be terminated subsequent to an "audit" by CUMIS for failure to meet the underwriting standards. This would most commonly occur due to consumer law violations on forms or in policies and/or practices.

SB.8 SENDING NOTICE OF LOSS TO SURETY

The most common notice to surety which examiners will institute will be a "notice of loss." This is the notice that will be made in the event of a monetary loss due to violations of consumer laws and agency actions under the Truth in Lending and/or the Equal Credit Opportunity Act.

The purpose of sending a notice of loss to the surety company is to put the surety on notice that a claim may be forthcoming and to protect the credit union's rights to recover under the bond. The letter giving notice of loss in some cases may also contain a request that the surety inform the credit union as to whether bond coverage continues as it applies to the responsible person. However, CUMIS waives the right of subrogation in its consumer legislation endorsement. Therefore, it may not be necessary to name the responsible party in order to file a sucessful claim.

The letter notifying the surety of the loss can usually be very short. It is not necessary to know the exact amount of the loss before giving the notice; in fact, a delay until the specific amount is known could jeopardize collection of the claim if surety's rights were prejudiced by the delay in notification.

Following are the minimum essential items that should be covered in the letter to the surety company notifying it of a loss:

a. Statement that a loss has been discovered.

b. The amount of the known loss at the time of the notice.

c. Request for acknowledgment of the notice of loss, usually through provision of proof of loss forms, if a claim is going to be made.

An example of a typical letter of notice of loss is as follows:

Date

ABC Insurance Company
Any Street
Anytown, USA

Gentleman:

Subject: Bond Number ________________

Violations of the Truth in Lending Act and Regulation Z which will apparently require reimbursement to our members have been discovered by the National Credit Union Administration. A preliminary estimate indicates total reimbursements of approximately $______. We are searching our records for additional violations which will require reimbursement.

We have instituted procedures to ensure that subsequent violations of this type do not occur.

Please send proof of loss forms so that a claim may be filed. We are covered by the consumer legislation endorsement.

Sincerely yours,

President,

______FCU

SB.9 SURETY'S OBLIGATION TO PAY CLAIM

The terms of the bond specify that the surety company has a certain number of days after a proof of loss is filed to investigate the loss. Unless payment is received within a short time thereafter, the directors should follow up and request prompt settlement. (The surety company should not be permitted to stall settlement of claims for many months. If it denies a claim, it should do so promptly and advise the credit union of the reasons for the denial.)

The examiner should keep in close contact with any credit union in his or her district that has filed a claim with a surety company. If the surety should stall settling a valid proven claim, the consumer examiner should urge the directors to follow up promptly. Copies of all correspondence between the credit union and the surety should be forwarded to the regional office so that it can keep in close touch with the progress made. The examiner, in some cases, may wish to consult the Chief of Consumer Affairs about advising the credit union to engage an attorney to protect its interests.

ADMINISTRATIVE REPORTS AND PROCEDURES

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ARP.1 EMPLOYEE TIME REPORT (NCUA 1101) GENERAL

The Employee Time Report, NCUA 1101 (Rev.8/75) is a four-part form for all examiners, to be completed each Friday and on the last work day of each month. Distribution for consumer examiners is as follows:

Original to the Washington office in the goldenrod envelope provided. In all cases the time report completed on Friday is to be placed in the mail on Friday. In addition, the original of the time report prepared on the last work day of each month is to be placed in the mail to the Washington office on the same day.

First copy to the regional office on Friday of each week for payroll input. The month end cut-off time report may be retained by the examiner and mailed on Friday along with the time report which completes the week in which the end of the month came.

Second copy to the regional office for the Chief of Consumer Affairs. This copy is to be mailed in the same envelope as the other regional office copy.

Third copy to be retained by the consumer examiner.

Each NCUA 1101 will cover a one-week period, Sunday through Saturday, except for a week which includes the end of a month. At the end of each month it will be necessary to prepare a time report to include the period from Sunday through the last day of the month, and a separate time report to include the period from the first day of the new month through Saturday.

The NCUA 1101 is in key punch format for computer input. Instructions for completing it are as follows:

a. Header Line

(1) NAME BLOCK: Enter last name, and first and middle initial only.

(2) CARD COLUMNS 1, 2 and 3: Preprinted. No entry is necessary.

(3) EMPLOYEE NUMBER (CC4-7): Enter four digit number as assigned by the regional office.

(4) EMPLOYEE TYPE (CC 8): Enter the one digit alphabetic employee type code. An employee type code table is included in section ARP.1-2.

(5) REGION (CC 9): Enter home region assignment. Region will be entered as an arabic number. Consumer examiners on detail to another region will enter their home region in this block. The region in which work is performed will be entered in one of lines 01-08.

(6) SUPERVISORY EXAMINER (CC 10): Enter the letter Z.

(7) WEEK ENDING (CC 13-16): Enter the month and day on which the week ends. If the week ends on Saturday, May 13, the entry will be 0513. This day must ALWAYS be a Saturday, or the last day of the month for month end cut-off reports.

b. Lines 01 Through 08:

The series of line entries numbered 01 through 08 are for capturing productive time reported by work classification codes (WCC), 5 through 39 only. A list of applicable WCCs is published as 1101(a). These series are designed to capture productive work where it is performed. (The line numbers themselves are of no particular importance to NCUA employees; they are used in computer data conversion.) For example, should an examiner work the entire week in his or her home region and in one district only, line 01 would be filled out to record productive time under the appropriate WCC. If during the week the examiner went to another district, the next open line for the work in the second district would be filled in even if the work involved the same WCC as earlier in the week. Employees on the regional office staff will complete lines 01 through 08 with arbitrary district 99 for productive work unless working in the field and performing productive work in a specific district. Note that the column under WCC has three spaces (CCs) under card columns 25, 26 and 27. CC 27 has been included to provide potential for gathering specific information about examinations. It is not to be filled in unless specific instructions are issued for its use. When completing the blocks under the columns headed Sunday through Saturday, enter all time worked to include any overtime or compensatory time using the WCCs that designate which work was performed. Overtime and compensatory time are entered again in lines 22 and 23 under their own WCCs.

Enter total work units completed for each line. If an examination is not completed during the week, do not enter a work unit. The work unit will be entered for the week during which the examination was completed. For team examinations, the team leader only will report the work units completed on the NCUA 1101.

c. Line 09:

This line contains totals of lines 01-08 and includes all overtime and compensatory time, if applicable.

d. Lines 10 through 20:

These lines are to be used to record non-productive time, WCC 40-70. There are no work units involved in these codes. Each WCC need appear only once on these lines. Note that WCCs 67, 68 and 70 are preprinted on the form. All annual and sick leave and compensatory time used will be entered on these lines.

e. Line 21:

This line contains a total of all time reported on lines 01-08 and 10-20, including any overtime and compensatory time earned.

f. Lines 22 and 23:

Extract the overtime paid and compensatory time earned, if any, that is included in line 21 and show separately for each day and under total hours.

g. Remarks:

See section ARP.1-4 of this Guide.

h. Itinerary:

See section ARP.1-5 of this Guide.

ARP.1-1 SPECIAL INSTRUCTIONS TO PROVIDE FOR INTRA-REGIONAL TRANSFERS, INTRA-REGIONAL DETAILS AND INTER-REGIONAL DETAILS

In order to permit the time system to present a true picture of performance of examiners and permit a proper accounting of time spent on detail to another region, the following procedures will be used:

a. If an employee is permanently transferred either from financial examiner status or from the regional office to become an examiner or from examiner status to the regional office, he or she will report all time for the remainder of that fiscal year (subsequent to the transfer) under an adjusted employee number. The adjusted employee number will be the employee's regular 4 digit number with a 1 placed in the first digit. For example: number 0072 would become 1072 and 0531 would become 1531. If for some reason during the same fiscal year, the employee is transferred back to his or her original status, he or she would revert to reporting under his or her original base number; back from 1072 to 0072 or 1531 to 0531.

b. The use of the adjusted employee number will continue only during the fiscal year the transfer was made. On October 1 of the next fiscal year, the employee will revert to his or her original base number, again, from 1072 back to 0072, etc.

c. Upon detail to his or her own regional office, the examiner will commence using the adjusted employee number. For example: number 0072 would become 1072 and 0109 would become 1109. Also, the examiner will commence using SE code "Y" designating regional office duty and will appropriately use the work classification code for tasks performed while on regional office detail. Upon completion of the detail, the adjusted employee number will revert to his or her basic number. For example: 1072 would become 0072 and 1109 would become 0109. Also, the SE code would revert to Z. Consider the following:

> Consumer Examiner, employee number 0072, worked in Region II. Effective June 7, 1976, Examiner is detailed to his or her regional office for two weeks. During that two week period, Examiner uses employee number 1072, Region II. Upon termination of the detail, he or she will revert to 0072/2/Z.

d. Should an employee of one region be detailed to another region for periods exceeding one week, that employee will report time under an adjusted number for the entire period of the detail. He or she will also use the region number of the detailed location. The employee will revert to the original base number upon termination of the detail. Should such a detail terminate during a week, two time reports will have to be submitted, one with the adjusted number covering the number of days during the week involved in the detail and another with the original base number showing the number of days in that week spent back in his or her home region.

e. In the case of an employee detailed more than one time during a fiscal year to more than one region, there would have to be a second adjusted employee number. In this case it would be his or her original base number with a 2 placed in the first digit. Consider the following example:

Employee Number	Duty Station
0600 (base)	Region I (home) 1/1/78-2/17/78
1600	Region II 2/18/78-3/10/78
0600	Region I (home) 3/11/78-6/16/78
2600	Region III 6/17/78-7/21/78
0600	Region I (home) 7/22/78-9/23/78

In this case, if a third detail should occur to a region other than II or III, there would be a 3 placed in the first digit during that period of detail.

f. Should an employee who was first transferred within his or her home region as described in paragraphs a. and b., above, be subsequently detailed to another region, that employee would go into the second step of his or her adjusted employee number. For example:

Employee Number	Duty Station
0650 (base)	RO Staff, Region I 1/1/78-3/24/78
1650	Examiner, Region I 3/25/78-9/30/78
2650	Detailed Region II

During the periods 3/25/78 - 5/19/78 and 7/22/78 - 9/30/78 employee number 1650 would be used since he or she returned to Region I as a consumer examiner.

8. Essentially, each employee is responsible to keep track of his or her own activities and report his or her time under the appropriate employee number. However, regional directors and Chiefs of Consumer Affairs are responsible for the actions of their subordinates and those detailed to them. Any need for corrections to time forms submitted will be directed to the regional director concerned.

ARP.1-2 EMPLOYEE TYPE CODES

Employee Type Codes are used to accumulate Work Classification Code time data by employee category. They are used only on the Employee Time Report, NCUA Form 1101.

Employee Category	Code
Regional Director	A
Assistant Regional Director	B
Chief, CIL	C
Review Staff	D
Insurance Analyst	E
Chief, S & E	F
Student Trainee	G
Clerical	H

Supervisory Examiner	J
Financial Examiner	K
Examiners Detailed to Regional Office	L
Washington Staff	M
Regional Office Staff Detailed to Another Regional Office	N
Regional Office Managers	P
Liquidation Specialist	Q
Consumer Affairs Analyst/Specialist	R
Chief, Consumer Affairs	S
Consumer Affairs Clerical/Technician	T
Consumer Examiner	U

ARP.1-3 OVERTIME AND COMPENSATORY TIME

a. General Policy on the Work Week and Overtime/Compensatory Time

The normal work week consists of five 8-hour days, Monday through Friday. All compensable work performed in excess of that, or on Saturday or Sunday, is overtime, either paid or compensatory. The conditions under which examiners can be paid for or take compensatory time for approved overtime are discussed in Chapter 11 of the NCUA Personnel Manual. An orderly completion of workload during the regular work week without the use of overtime is especially important for a self-financing program. Careful advance planning by each examiner to complete his or her daily work within the regularly-established 8 hour work day will help to achieve this goal. This planning ability is one factor considered in the evaluation of the examiner's performance.

b. Authorization and Approval of Overtime

Overtime will be paid or compensatory time granted for time required in excess of 8 hours a day (or 40 hours per week) only if it is authorized or approved by the Chief of Consumer Affairs. When work cannot be performed during the regular work day, approval to work overtime must be obtained in advance from the Chief of Consumer Affairs unless the overtime is for examination work. To minimize calls to the Chief, examiners are authorized to work overtime on examination work other than writing the report, provided that such overtime is commented on in the "Remarks" section of Form NCUA 1101, which briefly states the reasons why that work could not have been performed during the regular work day.

c. Reporting of Overtime

For each work day of more than 8 hours, overtime should be recorded in the appropriate time category, and the number of overtime hours entered on Line 22 or 23 of Form NCUA 1101.

All overtime which is not for examination work must be approved in advance, the date of the approval and the name and title of the person who granted it should be included in the "Remarks" section of Form NCUA 1101.

Since each examiner is assigned work or an annual basis and is responsible for planning his or her work program, there should be no instance when a work day will consist of less than 8 hours.

ARP.1-4 REMARKS

As there exists a need for charter number reference on the Form NCUA 1101, the examiner will show the charter number for Federal credit unions and the insurance certificate number for State credit unions of each credit union examined, investigated or visited for a supervisory contact in this space. Five symbols will be used as follows:

WIP-for work in process

SWIP-supervisory contacts-work in progress

C-for completed examination

SC-for completed supervisory contacts

IC-for complaint investigation completed

The hours that have been expended for WIP and SWIP entries should be shown in parenthesis between the charter number and the symbol, e.g., 20521 (6) SWIP. For completed work, the charter number may be shown immediately to the right of the line reporting the hours. This could cause the use of two or more lines if only WCC 09 was used on the form but two or more credit unions were examined during the week

ARP.1-5 Itinerary Section

The Itinerary Section should reflect the proposed itinerary for the next ten working days beginning with the Sunday following the date on which the report is prepared. Scheduling work for the coming two weeks will require the examiner to give consideration to his or her assignments and work in progress. Effective planning is essential in order to give appropriate preference to the various cases assigned and to avoid loss of time and needless expense. The major portion of an examiner's time will be devoted to examinations, with special assignments and other work being "dovetailed" into the examination program. Estimating the amount of time required to complete a particular job will be the responsibility of the examiner. Experience will enable him or her to estimate with a satisfactory degree of accuracy the amount of work that may be accomplished in the period to be covered in the report.

Tentatively planning the work schedule a month or more in advance will be helpful in most instances, particularly if the examiner is working on scattered cases which involve considerable travel.

Only the day of the month need be inserted in the "Date" column. The charter number of the credit union to be contacted should be listed in the "FCU No." column and the credit union's name (in abbreviated form, if necessary) and its address (city and state only) should be shown in the "FCU Name and Location" column. If necessary, two lines can be used to identify other proposed contacts besides those with credit unions.

Work Classification Codes (WCCs) defining the type work to be performed will be used in the "Symbol" column. The WCCs are published as NCUA 1001(a).

It is essential that the Chief of Consumer Affairs be able to communicate readily with the consumer examiner in the field so that emergencies may be properly handled. The examiner's mailing address shown on the report for the ensuing two weeks should be complete and accurate. When it is necessary for the examiner to use a "General Delivery" address, he or she should call at the post office at the first opportunity upon arrival in town. As soon as a more definite address is known it should be promptly furnished to the Chief of Consumer Affairs in the regional office. The examiner should also immediately inform the Chief of Consumer Affairs when it is necessary to change his or her itinerary, if the mailing address will be different from the one shown in the report.

ARP.1-6 COMMUNICATION OF OVERTIME/LEAVE TO THE REGIONAL OFFICE

To insure that payroll time and attendance cards are completed and forwarded promptly by the regional office, examiners are to telephone the Regional Office Timekeeper on the Friday of each concluding pay period to report overtime worked and/or leave taken in the current week.

ARP.2 LONG-DISTANCE TELEPHONE CALLS

Long-distance telephone calls may be made to the Chief of Consumer Affairs in the regional office or to other points by means of FTS if the purpose is official business and other means of communication will not suffice. The subject matter should be well organized and as brief as possible consistent with an adequate treatment of the purpose of the call. If FTS is not available, calls to the regional office should be made "collect," unless otherwise instructed by the regional director. Other long-distance calls should be paid for and reimbursement claimed in accordance with the provisions of the Standardized Government Travel Regulations.

ARP.3 TELEGRAMS

Telegrams may be used in some instances to advantage in lieu of long-distance telephone calls. The General Services Administration maintains a teletype network system which should be employed as extensively as possible. When an examiner is in one of the cities which has this service and wishes to send a telegram, he or she may file the message by telephone or by personal visit to the General Services Administration office. The teletypewriter centers will accept messages addressed to the regional office as well as to non-governmental addresses, such as credit union officials. The charges for the messages will be billed directly to the National Credit Union Administration and the consumer examiner should make no payment for such services. The regional office will provide the examiner with a list of the teletypewriter centers in his or her region.

ARP.4 REQUESTS FOR SUPPLIES AND FORMS

Each examiner should maintain a reasonable stock of report forms and other supplies used in the performance of his or her official duties. This material will be requisitioned from the NCUA Distribution Center. Sufficient supplies to meet the examiner's needs for the ensuing three-month period should be ordered at one time. However, stockpiling of forms will be avoided. Form NCUA 1565 is the prescribed form for requisitioning forms and supplies. Fill out and send the top copy to the Distribution Center and keep the duplicate copy for your records.

ARP.5 PERSONAL EXPENSE VOUCHERS

Expenses incurred by employees while traveling on official business will be reimbursed by the Administration, subject to the limitations contained in the Standardized Government Travel Regulations, as amended, and subject to the provisions of the NCUA Travel Manual. In order to be able to properly prepare a personal expense voucher, the employee should be familiar with these regulations. Extreme care must be used in preparing a travel voucher. Errors will cause a delay in receipt of funds.

ARP.6 ANNUAL, COMPENSATORY AND SICK LEAVE

Annual leave, generally, must be approved in advance by the Chief of Consumer Affairs or the regional director. An exception is leave of an emergency nature for a short period where prior approval is not possible. The regional office should be informed promptly of any sick leave taken. All leave must be applied for on Standard Form No. 71, APPLICATION FOR LEAVE, except leave for examiners who may be physically located in the regional office where Time and Attendance Cards can be initialed by the employee. Specific instructions on the taking of leave will be given to each examiner by the regional office. Compensatory leave accumulated cannot be carried forward and, therefore, must be used prior to the end of the leave year. Accordingly, any overtime worked in the last two weeks of the leave year chargeable as compensatory leave is to be used. If it cannot be used, paid overtime should be requested rather than compensatory leave. A complete discussion of the type of leave which is available is found in the booklet "Your Job in NCUA," which is given to all new employees of the National Credit Union Administration.

ARP.7 REPORT OF ACCIDENTS, PERSONAL INJURIES, PROPERTY DAMAGE, ETC.

a. On-The-Job Injuries

The Federal Employees' Compensation Act provides many benefits for employees who are injured at work or contract a work-connected illness. These benefits include necessary medical care, disability payments when the employee is in a nonpay status because of the injury or illness, compensation payments to surviving dependents, and up to $800 for burial expenses if death results from injury or illness.

Every on-the-job injury should be reported immediately to the regional office. If an examiner is injured while on duty in the field, he or she should arrange for medical treatment by the Government physician, if available, otherwise by a duly qualified physician. Slight injuries should not be neglected; many unattended minor injuries often prove serious. The Employee's Notice of Injury or Occupational Disease (Form CA-1) should be prepared by the injured employee and submitted to the regional office within 48 hours of the accident. (The employee should keep one copy and submit the original and one copy to the regional office.) If the employee is unable to prepare the form, someone should do it for him or her. Since this notice is also the employee's original claim for compensation, it should be submitted in order to protect the employee's rights to compensation even if the injury did not require medical treatment.

If the injury results in a disability continuing beyond three days of pay loss, compensation is payable beginning with the fourth day. Questions regarding benefits under the Federal Employee's Compensation Act should be directed to the regional office. Benefits provided under the Federal Employees' Health Benefits Act do not apply when treatment, care, or service is covered under the Federal Employees' Compensation Act.

b. Motor Vehicle Accidents

An examiner licensed as a U.S. Government Motor Vehicle Operator (Standard Form 46), who is involved in an accident will notify (Standard Form 91) the Chief of Consumer Affairs or the regional director. Public Law 87-258 amended the Federal Tort Claims Act (Title 28 U.S.C. 2671, et seq.) to provide for the defense by the Department of Justice of suits against Federal employees arising out of their operation of motor vehicles in the scope of their employment. It also provides that suit against the Government is the exclusive remedy in such cases. This statute also imposes upon the Department of Justice the responsibility for determining whether the Federal employee involved in such a suit was acting in the scope of his employment for purpose of that law.

Any employee of the agency (or his or her personal representative, if the action is brought against his or her estate) against whom a law suit is brought for damage to property or for personal injury or death (or who receives information that such action will be brought against him or her on account of his operation of a motor vehicle in the scope of his or her Federal employment) shall inform the regional director as soon as possible. The employee will furnish copies of any notification relative to the claim to the regional director who will forward the claim and all pertinent papers to the Office of General Counsel.

The provisions of this bill do not relieve employees of financial responsibility or agency disciplinary action when they are involved in an accident where it is determined that they were not operating a motor vehicle within the scope of their employment or that they were on personal business. The need still exists for employees to maintain adequate liability insurance to protect themselves financially, and in many instances, to satisfy state requirements.

ARP.8 ACTIVITIES AND OUTSIDE EMPLOYMENT

a. Activities

Regulations which govern Employee Responsibility and Conduct (Title 12 CFR Part 735), were made applicable to employees of the National Credit Union Administration as of February 22, 1972. Each examiner is given a copy of Chapter 5-110 of the NCUA Operations Manual which contains these regulations when he or she is appointed. The Office of Personnel Management requires that the regulations be reviewed on an annual basis.

b. Outside Employment

Examiners are free to engage in outside work or activities which do not conflict with their responsibilities as National Credit Union Administration employees. Outside work or activity which interferes with working hours or efficiency is prohibited. Likewise, employees of the National Credit Union

Administration are not permitted to take jobs which might involve the use of confidential information secured in connection with any matter in which the Government has an interest. Notification of outside employment is to be made in accordance with the procedures set forth in Title 12 CFR Part 735.

ARP.9 PUBLIC RELATIONS-GENERAL

Good public relations are essential to the proper discharge of the responsibility placed upon the examiner in consumer compliance contacts with Federal credit unions. This applies to the examiner's relations with individuals as well as with local, state and national credit union organizations.

An examiner's most frequent contact with the public is with the officials of individual credit unions. The same principles and techniques which achieve good relations with local credit union officials apply to relations with local chapters, state leagues, and national credit union organizations.

The examiner must be thoroughly aware of his or her ultimate responsibility to the credit union movement if he or she is to avoid conduct and attitudes which create bad public relations. He or she must understand that credit union organizations are representative of the people and are responsible to them. Basically, the ultimate goals of credit unions and their trade organizations and of the supervising agency are the same, although the functions of each and the lines of responsibility to the people are somewhat different.

The basis of good public relations is mutual knowledge of the objectives and functions of the people and organizations that come into contact with each other. Examiners should become acquainted with the credit union people in their district and the representatives of trade organizations and should help them to know the examiner's functions and objectives. If mutual understanding exists, there can be good public relations even though differences of opinion arise on certain questions.

ARP.10 RELATIONS WITH CREDIT UNION CHAPTERS

Active local credit union chapters are an effective aid to the development of the credit union industry. They provide an excellent opportunity for examiners to be of service to many credit unions with the expenditure of a minimum amount of time. Compliance with consumer laws, development of effective membership education and solution of individual credit union problems are all activities in which the consumer examiner has a mutual interest with the chapter. Assistance to the chapter can enhance the examiner's own efforts many times.

The alert examiner, where appropriate, will give encouragement and support to local chapters. This can be done without going beyond his or her functions as an examiner. It is important to understand the functions of the chapter and the examiner. A clear understanding of these functions makes it obvious that the examiner cannot accept any office, be a delegate or serve as a teller of an election in the local chapter nor become involved in any of its internal politics. His or her cooperation with the chapter on mutual objectives will be more effective if a clear separation of functions is maintained.

Examiners may participate in chapter meetings when invited to do so. Such invitations should be accepted whenever possible without interference with assignments and without incurring excessive travel costs. Examiners can gain much in understanding the credit union industry and of the thinking of leaders in their districts by attending chapter meetings. If overtime is involved, prior clearance with Chief of Consumer Affairs will be needed for such meetings. Otherwise, unless the Chief has instructed to the contrary, the examiner need not obtain clearance.

ARP.11 RELATIONS WITH STATE CREDIT UNION ASSOCIATIONS

Cooperation with state-wide credit union organizations (usually called Leagues) which are formed to aid the progress of the credit union industry is highly desirable. Participation on the program of league meetings, upon invitation, is also desirable. Such participation can help build better public relations with these organizations. The examiner should avoid arguments with league officials. Honest differences of opinion should not be permitted to lead him or her away from the many mutual objectives and activities in which cooperation is so desirable.

Cooperation with state-wide credit union organizations in such activities as training programs for credit union officials and in handling problem cases is not only permissible but highly desirable. Examiners should not become involved in internal politics of these organizations, however, and they cannot serve as officials, delegates, or tellers of elections of such organizations for the same obvious reasons which apply to local chapters.

ARP.12 RELATIONS WITH NATIONAL TRADE ASSOCIATIONS

The examiner's contact with national trade associations and their officials will usually be less frequent than with local and state organizations. Since the examiner may not always be fully informed of all national developments, contacts with national association officials should be tempered with good judgment in any discussion of national affairs. Relations with national associations in connection with matters of a nation-wide scope will generally be handled by the Washington office.

When requested, the examiner may give representatives of national assciations information and suggestions as to general credit union conditions in the area with which the examiner is familiar. He or she should cooperate with such representatives in the development and furtherance of the basic credit union objectives within the limits of his or her authority and to the extent that is possible without interference with his or her primary function as a consumer examiner.

ARP.13 RELATIONS WITH OTHER GOVERNMENT AGENCIES

The examiner's relations with other government agencies generally fall into two classes: Those contacts which are initiated by another government agency and those which are initiated by the examiner.

a. Contact Initiated by Other Government Agencies

Other government agencies may request the assistance and cooperation of examiners or may request information from them. The examiners should make reasonable efforts to cooperate provided it does not interfere with the performance of their duties. Information of a confidential nature about a particular credit union should not be released without approval of the regional office. If the examiner is in doubt, the Chief of Consumer Affairs should be consulted. Instructions pertaining to the disclosure of official records and information are set forth in Part 720 of the NCUA Rules and Regulations.

b. Contacts Initiated by the Consumer Examiner

Examiners may contact other government agencies to obtain information necessary to carry out their assigned duties. Contacts which involve matters of state-wide or national concern should be made only upon instructions from the Chief of Consumer Affairs.

ARP.14 RELATIONS WITH COMMUNITY ORGANIZATIONS

Within the limitations imposed by law on political activities of Federal civil service employees, examiners will follow their own judgment and inclination in the matter of joining and participating in the work of organizations in their communities.

Examiners may be called upon to participate in community activities by credit union leagues, clubs, schools, and other community organizations. Where such activity will promote good public relations, it is entirely proper for examiners to engage in non-partisan discussions, forums, or other public functions aimed at informing or activating the organization. The examiner should obtain prior clearance from the Chief of Consumer Affairs, however, if participation in such functions is part of his or her official duties.

ARP.15 FORMAL SPEECHES

For this discussion, a "formal speech" is considered to be a planned talk on some credit union subject which is part of a scheduled program. If asked to make a speech at a league or chapter meeting, or at a meeting of another organization which has an active interest in the credit union movement, the examiner should not hesitate to accept if this activity will not unduly interfere with his or her regular work. The examiner should discuss this matter with the Chief of Consumer Affairs if there are any doubts about the appropriateness of his or her attending and participating in any such meeting. In any case, the Chief should be notified of the examiner's participation in any such meeting.

The examiner will give adequate time to the preparation of the speech and endeavor to make the presentation reflect credit upon the Administration and upon himself or herself as a credit union leader. The examiner will make certain that all statements of fact are accurate and that all policy statements covered by the discussion have been approved for public pronouncement. Controversial issues should be avoided and the examiner should make no unauthorized commitments for the Administration.

If the subject of the speech is limited to published credit union policies and procedures, prior approval need not be obtained from the Chief of Consumer Affairs. If the examiner has any question about anticipated policy statements or positions he or she should submit a copy of the planned speech to the Chief of Consumer Affairs (who in turn may decide to forward it to the regional director for approval) well in advance of the meeting date. If the Chief has any questions concerning the content of the speech, he or she should discuss them with the regional director.

An outline will be prepared by the examiner, prior to any speaking engagement. After the presentation, a copy of the outline will be forwarded to the Chief of Consumer Affairs. The Chief will forward a copy to the Office of Consumer Affairs. Files will be maintained in the regional and Washington offices for use in future speaking engagements.

ARP.16 WRITING SIGNED ARTICLES FOR PUBLICATION

Articles which are to be signed by the examiner in his or her official capacity must have approval of the Chief of Consumer Affairs and regional director prior to publication. Two copies of the article, together with full information as to its proposed use, should be forwarded to the regional office long enough in advance of publication date to permit clearance with the Washington office, if necessary.

Any such article should be carefully prepared. Factual information must be accurate and policy statements must be correct. The article should present a definite message, cover the subject adequately, be well organized and be grammatically correct.

ARP.17 MEMBERSHIP AND PARTICIPATION IN THE MANAGEMENT OF CREDIT UNIONS

NCUA employees are not permitted to actively participate in the management of credit unions, since to do so might result in a conflict with their basic duty of supervising the operations of Federal credit unions. An objective approach must be taken by employees if they are to fully carry out this duty.

All NCUA employees may become members of Federal and state credit unions in the ususal manner provided they are within the field of membership and provided their applications are approved in the customary manner. No employee of the NCUA, however, may serve as a director, committeeman, officer, employee, delegate, or teller of an election of a Federal or state credit union.

An examiner will not be the examiner-in-charge of any examination where he or she has a loan balance in excess of his or her share account. If an examination assignment is made of a credit union where the examiner has borrowed in excess of his or her shareholdings, he or she should promptly report this fact to the Chief of Consumer Affairs so that another examiner can be assigned.

The examiner should meet promptly his or her scheduled payments on any loans made with credit unions as well as on any other financial obligations. Failure to do so can bring discredit to the examiner and be a source of embarrassment to the Administration. The examiner should not cash checks at any Federal credit union unless he or she is within the credit union's field of membership and is a member of such organization.

ARP.18 RELEASING INFORMATION CONCERNING CREDIT UNIONS UNDER THE CONSUMER

EXAMINER'S SUPERVISION

Examiners may be called upon from time to time to disclose various types of information concerning credit unions under their supervision. This information usually can be classified readily as being either permissible or confidential.

Permissible information is any information which has been published or otherwise released by the Administration to the general public. The media through which this information is released includes: Annual Report of the Federal Credit Union Program, NCUA Quarterly, Credit Union Statistics (monthly release), State-Chartered Credit Unions (Annual Report), instructional and informative material supplied to credit unions, formal speeches and signed articles by officials of the Administration. The examiner may release permissible information to credit union people and others upon receipt of a request.

Confidential information is information which is so listed by Part 720 of the NCUA Rules and Regulations. Information in this category may be released under certain conditions when specifically authorized by the Chairman. Records and information pertaining to examinations or investigations of Federal credit unions, official reports made to the Administration, and internal operations of the Administration constitute confidential information. Information as to the compliance problems and financial condition of individual credit unions and as to their members or their officials, for instance, also comes within this category. Requests for confidential information should be referred to the regional office. The examiner should not release confidential information without express written authorization. This rule does not prevent a examiner from cooperating with associations of credit unions or with sponsoring organizations in joint corrective efforts toward the improvement or reorganization of credit unions in need of such assistance. This type of cooperation can be promoted and effectively entered into without the release of confidential information.

ARP.19 EXPRESSION BY THE CONSUMER EXAMINER OF POLICIES OF THE ADMINISTRATION

The examiner's authortiy to speak officially for the Administration is limited to matters pertaining to the organizaiton and operation of Federal credit unions and contained in the Federal Credit Union Act, bylaws, instruction manuals, and informational material. The examiner's right to express his or her personal opinion on other matters is circumscribed only to the extent that he or she must clearly differentiate between expressions of personal opinions and expressions of official policies of the Administration.
A word of caution is necessary in this connection, since credit union officials and others who know of the examiner's official position quite often will consider all statements of the examiner as official.

ARP.20 WRITTEN COMMUNICATIONS WITH FCUs AND TRADE ORGANIZATIONS

The following policies are hereby established regarding the subject:

a. Examiners will not initiate correspondence with members or officials of FCUs and trade associations on matters which fall within the purview of the NCUA Board, regional director or Chief of Consumer Affairs.

b. A examiner may acknowledge and respond to correspondence received from members or officials of FCUs located in his or her assigned district. If the subject matter is not within the consumer examiner's purview, he or she will forward the letter to the Chief of Consumer Affairs. When the examiner anticipates a delay in the response, he or she will acknowledge receipt of the letter and inform the writer that a reply will be made.

c. In corresponding with members or officials of FCUs, the examiner will exercise the judgment and restraints currently applicable to the writing of the open section of the report of examination. The examiner will not write on matters which would not be included in the open section of a consumer compliance report of examination. He or she will seek the guidance of the Chief of Consumer Affairs when uncertain about the handling of such correspondence.

d. Examiners will confine correspondence with trade associations to district-related matters and will correspond only with local representatives of such associations. In correspondence dealing with a specific credit union, the examiner will not divulge information which can be released only by authorization of the board of directors or by the Chairman of NCUA.

All correspondence will be prepared on official stationary designed specifically for examiner use.

All correspondence prepared by examiners will be professional in appearance and content.

Copies of incoming correspondence and copies of the examiner's response will be forwarded to the regional office for post-review and updating of the files. The examiner may request copies of the incoming correspondence for his or her files.

ARP.21 CONDUCT AND PERSONAL HABITS

An examiner should demonstrate a courteous, business-like and cooperative attitude in all contacts with credit union people. Conduct and personal habits while on duty should be above reproach. While the Administration is not usually concerned with the activities of its employees while off duty and in no sense means to regulate their outside pursuits, it realizes that carelessness of speech and indiscreet conduct in public while off duty can be quite as discreditable to the examiner and as embarrassing to the NCUA as they can be while the individual is on duty.

Each examiner should be familiar with and follow carefully the Standards of Conduct.

APPENDIX 7

SELECTED FRB LETTERS

Number	Topic
FC-0014	Disclosure of multiple periodic rates and annual percentage rates - open end
FC-0051	Disclosure of method of computing balance on which finance charge is imposed
FC-0054	Other charges paid by the creditor; Disclosure in meaningful sequence; Acceleration is not a default charge; Attorney's fees and court costs are not automatically default charges
FC-0079	Combining debits and credits on periodic statement; Use of the term "Total FINANCE CHARGE"; Use of the plural of required terminology as column headings
FC-0083	Accural of interest on delinquent loans for simple interest loans
FC-0109	"Required minimum periodic payment" - amount to avoid delinquency
FC-0141	Disclosure of "other charges"
FC-0149	Open end credit initial disclosures on a "single written statement"
FC-0170	Open end credit initial disclosures of "other charges"; Open end credit initial disclosures on a "single written statement"
No. 120	360 vs. 365 days - credit unions
No. 154	Advertising - trigger terms
No. 281	360 vs. 365 days
No. 327	Periodic statement frequency - credit unions
No. 391	Advertising
No. 467	Advertising
No. 534	Advertising on periodic statements
No. 651	Open end credit initial disclosure of minimum periodic payment; Disclosure of "range of balances" in open end credit
No. 666	Disclosure of "finance charge" in closed end credit
No. 670	Meaning of "10 point type"
No. 689	Treatment of adjustment "debits"
No. 780	Disclosure in "meaningful sequence"; Disclosure of "additional information"
No. 793	Periodic statement frequency
No. 837	Disclosures when using bank (loan) drafts
No. 846	Disclosure of pledged shares
No. 849	Advertising
No. 876	Disclosure of minimum periodic payment - open end
No. 894	Disclosure of "payments" and "credits" - periodic statement
No. 994	Billings rights (error resolution) statement; "Credits" and "payments" in the same column - periodic statement
No. 1037	Credit life insurance disclosures for open end credit
No. 1044	Credit union statement of account is not closed end billing statement
No. 1047	Disclosure in "meaningful sequence"
No. 1053	Disclosure of security interest in "after-acquired property"
No. 1094	Disclosure of security interest in open end credit
No. 1130	Advertising - trigger terms
No. 1142	Supervisory committee notice on open end periodic statement
No. 1154	Combined note/disclosures completed by mechanical/electronic equipment
No. 1170	360 vs. 365 days - open end credit
No. 1287	Advertising
No. 1288	Billing er (error resolution) notices - "plain English" language

12 CFR Part 226, FC-0014

§ 226.7(a)(4) Disclosure of multiple periodic rates in credit union master open end credit agreement where rates will vary depending upon type of collateral given for each advance - example.

November 3, 1976

This is in response to your letter of . . . , in which you requested an official staff interpretation of Regulation Z § 226.7(a)(4) concerning the disclosure of multiple periodic rates and their corresponding annual percentage rates in connection with open end credit plans offered by certain credit unions.

In your letter, you indicated that credit unions operate open end credit plans under which customers may receive extensions of credit from time to time. According to the terms of the plan described in your letter, each new extension of credit must be secured by some form of collateral and the annual percentage rate that will be applicable to a given loan depends on the type of collateral offered as security.

In your letter you asked whether the following disclosure of the various periodic rates and their corresponding annual percentage rates would suffice for the purposes of § 226.7(a)(4):

> "I promise to pay at your address, all sums
> advanced from time to time on loan accounts
> under this open end secured loan agreement
> plus FINANCE CHARGE (interest) at the periodic
> rate of ______________ % per _________________
> which is at a corresponding ANNUAL PERCENTAGE
> RATE of __________ % for ____________________
> loans, except that the FINANCE CHARGE (interest)
> at the periodic rate of _________________ % per
> ______________ which is at a corresponding ANNUAL
> PERCENTAGE RATE of __________________ %, for
> ___________________ loans; and the periodic rate
> of ________________ per ________________ , which
> is at a corresponding ANNUAL PERCENTAGE RATE of
> ___________________ % for ______________ loans."

Staff feels that it should be noted that it has a policy of not reviewing forms and that § 226.1(d)(3) specifies that the staff has no authority to issue official staff interpretations approving creditors' forms. The question you have raised, however, concerns the sufficiency of a specific disclosure, and staff feels that it is proper within its authority to provide an official comment on the sufficiency of the disclosure.

Staff is of the opinion that the disclosure quoted above gives all the necessary information required under § 226.7(a)(4) but that there are both form and grammatical problems involved in this disclosure making it likely that a consumer might be confused as to its meaning. Staff suggests that the disclosure of the periodic and annual percentage rates for purposes of § 226.7(a)(4) might be revised and clarified to read as follows:

> For loans secured by ______________ the periodic rate is ___________ per cent per ______________ which corresponds to an ANNUAL PERCENTAGE RATE of ___________ per cent.
>
> For loans secured by ______________ the periodic rate is ___________ per cent per ______________ which corresponds to an ANNUAL PERCENTAGE RATE of ___________ per cent.

Staff believes that this disclosure, while not providing any information not supplied in your proposed disclosure, is less susceptible to confusion. Of course, to assure full compliance, you should make sure that the above disclosure or any other disclosure you choose to give meets the requirements of § 226.6(a) regarding conspicuousness, sequence, terminology, and size of type.

In closing, I would also like to add that this letter is in no way intended to express any opinion on any other aspect of the plan which you have established. Our opinion is based on the assumption that the plan is a valid open end credit plan, that all other disclosures are made as required by the Act, and that the terms of the plan are as you have disclosed in your letter.

This is an official staff interpretation of Regulation Z issued in accordance with § 226.1(d)(3) of the Regulation. I trust that it is responsive to your inquiry.

Sincerely,

Jerauld C. Kluckman
Assistant Director

12 CFR Part 226, FC-0051

§ 226.7(a), 7(b) § 226.8(b) General	Method of computing the APR is not a required disclosure.
§ 226.7(a) § 226.8(b)(4) § 226.8(b)(6)	Accruing finance charges on a loan where a daily rate is applied to the actual balance for the number of days the balance is outstanding does not involve prepayment penalty or late payment penalty if the payment is not made on the anticipated due date.
§ 226.7(a), 7(b)	Stating that finance charges will be computed on the outstanding balance at the applicable APR for the actual time the balance remains unpaid is, in this situation, a permissible method of disclosing the method of computing the balance upon which finance charges will be computed for open end credit accounts.

March 2, 1977

Due to unforeseen and unavoidable difficulties, this is a belated response to your letter of . . . , in which you asked questions regarding compliance with Regulation Z.

You state that your credit union charges interest on both open end and other than open end loans by applying a daily rate (i.e., the annual percentage rate divided by 365) to the outstanding balance for the actual number of days which that balance is outstanding. If a customer pays in advance of the anticipated due date, the only result is that interest is computed on the outstanding balance for the appropriate number of fewer days. If a customer pays later than the anticipated due date the only result is that the daily rate is applied to the outstanding balance for a longer number of days. No additional charge is imposed for prepayment or late payment, except that the rate is applied to the daily balance for the actual number of days.

You propose to place the following language on your disclosure statements:

> "The FINANCE CHARGE will be computed on the outstanding unpaid balance only at the ANNUAL PERCENTAGE RATE shown above for the actual time the balance remains unpaid. There shall be no other change in the FINANCE CHARGE for prepayment or late payment."

?ou ask whether the quoted language is an "adequate disclosure of the method of computation of the Annual Percentage Rate and of [the] method of computing the balance on which the interest will be computed and the method for computing the late payment and prepayment."

There is no requirement in Regulation Z that the method of computation of the annual percentage rate be disclosed. The only requirement with respect to disclosure of the annual percentage rate is that it be properly computed and disclosed as a numerical figure.

In staff's opinion, the situation that you describe does not involve the imposition of a prepayment or late payment penalty since, apparently, the only charge made is the imposition of the daily rate to the outstanding balance for the actual number of days that the balance is outstanding. Further, it is staff's view that a creditor need not supply a disclosure that there is no prepayment or late payment penalty. Consequently, staff believes that the last sentence of the quoted material, though arguably helpful to the customer, is unnecessary.

Staff believes that the first sentence of the quoted language is a permissible disclosure regarding the method of computing the balance upon which finance charges will be imposed. Staff would point out that this is a required disclosure only with respect to open end credit.

This is an official staff interpretation of Regulation Z issued in accordance with § 226.1(d)(3) of the Regulation and limited in its application to the facts as outlined herein. I trust that this is responsive to your inquiry.

Sincerely,

Jerauld C. Kluckman
Associate Director

Board of Governors of the Federal Reserve System,

Theodore E. Allison
Secretary of the Board

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BEST DOCUMENT AVAILABLE

12 CFR Part 226, FC-0054

§ 226.4(a)	Charges listed in 4(a) which are absorbed by creditor and not passed directly or indirectly on to customers are not finance charges.
§ 226.6(a)	"Meaningful sequence" does not require any particular arithmetical progression, but related terms must be presented so that customers can understand their relationship. (See also 780, 1047).
§ 226.8(b)	Right of acceleration is not an 8(b)(4) default charge, but if rebate upon prepayment after acceleration is different from rebate upon voluntary prepayment disclosed under 8(b)(7), the difference is an 8(b)(4) charge. (Clarifies 851).
§ 226.8(b)	Attorney's fees and foreclosure costs assessed automatically are 8(b)(4) charges; if not automatically imposed, need not be disclosed as such.

March 21, 1977

This is in reply to your letter of . . . , requesting official staff interpretations of the requirements of Regulation Z with regard to computation of finance charge, disclosure of late payment charges, disclosure of loan proceeds, and the meaning of the term "meaningful sequence." This letter is an official staff interpretation of these four matters.

Staff considers the three other questions raised in your letter as inappropriate for official staff interpretations at this time. An official interpretation concerning disclosure of a dealer's reserve is deemed inappropriate because the Board has proposed for comment an amendment and an interpretation of Regulation Z on this same subject. Similarly, an official interpretation concerning whether loan proceeds must be disclosed is deemed inappropriate because this question has been raised in *Pollock v. General Finance Corporation* a case currently pending in the United States Court of Appeals for the Fifth Circuit in which the Board filed a brief *amicus curiae*. An official interpretation of your question regarding disclosure of notary fees under § 226.8(d)(3) would be inappropriate since staff's position is not one upon which a creditor may wish to rely in a civil action. A response to that issue will, therefore, be provided in a separate unofficial staff letter to you.

To auswer your remaining four questions:

(1) You ask whether a creditor's *right* of acceleration upon default by the obligor must be disclosed as a default, delinquency, or late payment charge within the context of § 226.8(b)(4). It is staff's opinion that the phrase "default, delinquency, or similar charges in the event of late payments," found in § 128(a)(9) and § 129(a)(7) of the Truth in Lending Act and § 226.8(b)(4) of Regulation Z, refers to specific sums assessed against a borrower solely because of failure to make payments when due. It is staff's opinion that the mere *right* to accelerate contained in a contractual provision which sets out the creditor's right to accelerate the entire obligation upon a certain event (generally the obligor's failure to make a payment when due) is not a *charge* payable in the event of late payment. Therefore, it need not be disclosed under § 226.8(b)(4).

You refer to a prior Public Information Letter, No. 851, which discusses the right of acceleration. Staff believes that letter addresses a different issue than the one posed in your letter. Staff understands that letter to say that early *payment* of the balance of a precomputed finance charge obligation by a customer upon acceleration by the creditor is essentially the same as a prepayment of the obligation. Therefore, if the creditor does not rebate unearned finance charges in accordance with the rebate provisions disclosed under § 226.8(b)(7) when the customer pays the balance of the obligation upon acceleration, any amounts retained beyond those which would have been rebated under the disclosed rebate provisions do represent the type of charge that must be disclosed under § 226.8(b)(4).

(2) You ask a further question regarding what charges must be disclosed as default, delinquency, or late payment charges within the context of § 226.8(b)(4). Specifically, you ask whether attorney's fees and foreclosure costs assessed on a non-automatic basis at the sole discretion of the creditor need to be disclosed pursuant to that section. It is staff's opinion that, if the imposition of these charges is automatic (for example, if the charge becomes immediately due and collectible by virtue of default), the charges must be disclosed under § 226.8(b)(4). If, however, the imposition of the charge is not automatic but is conditioned upon employment of the services of an attorney to effect collection or expenditure of amounts in conjunction with foreclosure proceedings, such charge need not be disclosed under § 226.8(b)(4).

(3) You request an official staff interpretation regarding the requirement in § 226.6(a) that disclosures be made "in meaningful sequence." Specifically, you ask whether any particular arithmetical progression must be used in making the disclosures. You refer to the case of *Allen v. Beneficial Finance Co.*, 531 F.2d 797 (7th Cir., 1976), which has been interpreted by some to mean that the various disclosure elements must be arranged in a "summation column," as opposed to a

they are not part of the finance charge, they need not be itemized and disclosed under § 226.8(c) or § 226.8(d).

This letter is an official staff interpretation of Regulation Z, issued in accordance with § 226.1(d)(3) of the regulation, and limited in its application to the facts and issues presented herein. I trust it will be of assistance to you.

Sincerely,

Jerauld C. Kluckman
Associate Director

12 CFR Part 226, FC-0079

§ 226.7(b)(1)

Combining credits and miscellaneous debits for returned checks and mispostings and the like is permissible where each entry is individually disclosed. (See Letter 689.)

Use of term "Total FINANCE CHARGE" permissible when disclosing the total amount of finance charges on a periodic statement. (See Letter 1132.)

It is permissible to use the plural of terminology required by § 226.7(b)(1) when the term is used as the heading of a columnar set of entries. (See Letter 894.)

May 20, 1977

This is in response to your letter of . . . , in which you raised three questions regarding certain open end credit disclosures required by Regulation Z. I will pose your questions in the order you presented them. Staff's answer will immediately follow each question.

Your first question involves the proper method of disclosing debits, other than normal extensions of credit on the open end account. You state that the types of debits you are addressing consist mainly of entries to correct mispostings, to reflect returned payment checks, and the like. You state that Regulation Z does not appear to address the method of disclosing such debits. You state that some members of your client's association disclose such debits by providing a brief identification of each individual such debit and netting the total of such debits with the total of credits disclosed under § 226.7(b)(1)(iii) in a box labeled "OTHER CREDITS AND DEBITS." Some members, however, itemize credits and such debits separately without netting and label the debits using various captions, such as "DEBIT ADJUSTMENTS" and "+ ADJUSTMENTS."

You point out that our Public Information Letter 689, dated June 1, 1973, was written in response to an earlier inquiry from you raising the same question. In that letter, staff approved the method of making the disclosure under consideration herein.

Staff continues to believe that the disclosures discussed in letter 689 and in the preceding portion of this letter are permissible under Regulation Z.

Your second question is whether the creditor of an open end account may use the term "Total FINANCE CHARGE" on the periodic statement when disclosing the total amount of all finance charges imposed during the billing cycle. You point out that in Public Information Letter 1132 staff approved such a disclosure in the context of disclosing the total amount of the finance charge for a closed end credit transaction.

It is staff's opinion that such a disclosure (when the words "FINANCE CHARGE" are made more conspicuous than the word "Total" by the use of all upper case letters in the former and only an initial upper case letter in the latter) is also permissible for making the disclosure required by § 226.7(b)(1)(iv).

Your third question is whether a creditor may use terminology required by § 226.7(b)(1) in the plural when such terminology is shown as a columnar heading or as the heading of more than one column, when appropriate. You argue that Public Information Letter 894 stands for the proposition that terminology required by § 226.7(b)(1) may be used in the plural form when the related entries are made in columnar form and in the singular when each related entry is shown individually.

In staff's opinion, it is permissible to use terminology required by § 226.7(b)(1) in the plural form when the required terminology is used as a columnar heading or as the heading for more than one column and in the singular form when the required terminology is used in connection with each individual related entry, as appropriate.

This is an official staff interpretation of Regulation Z, issued in accordance with § 226.1(d)(3) of the regulation and limited in its application to the facts outlined herein. I trust this is responsive to your inquiry.

Sincerely,

Jerauld C. Kluckman
Associate Director

12 CFR Part 226, FC-0083

§ 226.8(b)

In simple interest loans, the continued accrual of interest on the unpaid balance after the date when an instalment payment is due need not be disclosed as a "default, delinquency, or similar charge payable in the event of late payments." Similarly, interest accrual after the maturity date of the loan contract need not be disclosed if the interest rate after maturity is the same as the rate stated in the loan contract or if the rate permitted by statute is lower than the stated rate.

June 20, 1977

This will respond to your letter of . . . . You request an official staff interpretation of Regulation Z as to whether or not the accrual of simple interest on the unpaid principal balance of a closed end credit transaction beyond the date on which an instalment is due is a "default, delinquency, or similar charge payable in the event of late payment" for purposes of § 226.8(b)(4).

In such transactions, the finance charge (or the interest component of the finance charge) is determined by application of a periodic rate (daily, monthly, or annual) to the unpaid principal balance for the actual period that the balance has been outstanding. As you note, the finance charge and annual percentage rate that are initially disclosed are computed on the basis of periodic instalment payments that will be payable by the borrower on certain dates or at fixed intervals. If these periodic instalments are made as scheduled, the interest that accrues on the decreasing principal balance will correspond to the finance charge (or the interest component of the finance charge) initially disclosed to the borrower. However, the finance charge (or the interest component of the finance charge) will vary from that initially disclosed if payments are received on other than the scheduled dates. A payment that is made by the borrower after its due date will result in the accrual of more interest, just as an instalment made in advance of its due date will result in the accrual of less interest. As to successive payment cycles, interest accrues from the date of the immediately preceding payment.

It is staff's opinion that, in the situation you describe, the continued accrual of interest beyond the date on which an instalment is due does not constitute a "default, delinquency, or similar charge payable in the event of late payment" for purposes of § 226.8(b)(4). If a creditor imposes a late payment charge in addition to the accrual of simple interest, such charges are, of course, subject to disclosure under § 226.8(b)(4).

You also ask whether a creditor must disclose that, after the maturity date of a simple interest loan contract, interest may or will accrue on any principal balance that remains unpaid.

It is staff's opinion that as to simple interest loans, such continued accrual of interest need not be disclosed if the periodic rate applicable after maturity is the same as the stated periodic rate under the loan contract, or if the rate permitted by statute after the loan maturity date is lower than the stated rate. Where the interest on the unpaid balance accrues at a higher rate after the maturity date, however, staff believes disclosure is required by § 226.8(b)(4).

This is an official staff interpretation of Regulation Z, issued in accordance with § 226.1(d)(3) of the regulation and limited in its application to the facts outlined herein. I trust this is responsive to your inquiry.

Sincerely,

Jerauld C. Kluckman
Associate Director

12 CFR Part 226, FC-0109

§ 226.7(a)

"Required minimum periodic payment" is that amount a customer is contractually obligated to pay in order to avoid his or her account being considered delinquent or in default.

September 2, 1977

This is in response to your letter of . . . , requesting an official staff interpretation of § 226.7(a)(8) of Regulation Z. Your bank provides a check cashing guarantee program to its cardholders. A participating merchant who is presented with a check by one of your cardholders will first call the bank to obtain a proper authorization number. Once authorization is received, the merchant accepts the cardholder's check in payment for the goods or services. If the check is later returned to the merchant unpaid, the bank will pay the merchant and debit the cardholder's account, treating the debit as a cash advance for purposes of descriptive billing and imposition of finance charges.

When the bank pays a merchant for a returned check, the cardholder's check cashing guarantee privileges are suspended until the next two required minimum periodic payments are made in a timely manner. The bank would like to give its customer the option of immediate reinstatement of check cashing privileges by remitting to the bank the entire amount of the returned check. You inquire whether giving the customer that option might be construed as altering the required minimum payment (presently four percent of the new balance or $10.00, whichever is greater) previously disclosed in accordance with § 226.7(a)(8), thereby requiring the bank to provide a notice of a change in terms pursuant to § 226.7(f).

You believe that the answer to your question depends upon the meaning of the phrase "minimum required periodic payment" in § 226.7(a)(8). You are concerned that if the phrase is intended to describe the amount a customer is required to pay in order to have every feature of an open end credit plan fully available for immediate use, then what your bank proposes would constitute a change in terms as meant by § 226.7(f).

Staff does not believe that this was the intended meaning or purpose of this phrase. Since your bank will treat immediate remission of the entire amount of any returned check as optional, and since the account will not be considered delinquent or in default if a customer elects to repay that amount over a period of time, we believe that no change in the "required minimum periodic payment" as meant by § 226.7(a)(8) will occur upon implementation of your bank's proposal. Accordingly, the provisions of § 226.7(f) would be inapplicable.

This is an official staff interpretation of Regulation Z, issued in accordance with § 226.1(d)(3) of the regulation and limited in its application to the facts and issues outlined herein. I trust it is responsive to your inquiry.

Sincerely,

Jerauld C. Kluckman
Associate Director

12 CFR Part 226, FC-0141

§ 226.7(a)

"Other charges" include charges that are automatically imposed upon default by the customer.

December 5, 1977

This is in response to your letter of . . . in which you inquired about the scope of the phrase "other charges" which appears in § 226.7(a)(6) of Regulation Z. Specifically, you ask whether a bank which "desires to have its [credit] cardholders contractually agree to pay all costs including attorneys' fees incurred by it in legal proceedings to collect the cardholder's indebtedness in the event of delinquency by the cardholder" would be imposing an "other charge" so as to necessitate making the disclosures described in § 226.7(a)(6).

Public Information Letters 331, 386, and 797 (copies of which are enclosed) state that charges imposed in the event of delinquency or late payment are "other charges" under § 226.7(a)(6). Staff believes that charges imposed in the event of default similarly are "other charges" so as to require the disclosures set forth in that section. The question you raised, however, is whether the various costs which may be incurred by your client in legal proceedings to collect an overdue debt owed by a cardholder, and which the cardholder is contractually obligated to pay, are charges imposed in the event of default.

It is staff's opinion that if the imposition of these costs is automatic upon default (for example, if they become immediately due and collectible by virtue of default), they constitute "other charges" to be disclosed pursuant to § 226.7(a)(6). If, however, the imposition of the charges is not automatic but, rather, is conditioned upon employment of the services of an attorney to effect collection or expenditure of other amounts in conjunction with collection efforts, then they are not the type of charges intended to be disclosed pursuant to § 226.7(a)(6).

This is an official staff interpretation of Regulation Z, issued in accordance with § 226.1(d)(3), and limited in scope to the facts and issues herein. I trust it is responsive to your inquiry.

Sincerely,

Jerauld C. Kluckman
Associate Director

12 CFR Part 226, FC-0149

§ 226.7(a)

"Single written statement" does not mean that initial open end disclosures must be placed on the same side of a single sheet of paper.

June 7, 1978

This responds to your . . . letters requesting official staff interpretations of §§ 226.4 and 226.7 of Regulation Z. This letter answers your final question; your other questions will be dealt with in a separate letter.

You ask whether the initial open end credit disclosures required by § 226.7(a) can be set forth on two sides of a single sheet of paper. Section 226.7(a) provides that disclosures be made on a "single written statement." You note that, in contrast to that section, § 226.8(a), relating to credit other than open end, expressly requires that disclosures be made "on the same side of the page" or on "one side of a separate statement." Thus, you argue that a creditor would be permitted under § 226.7(a) to place the required disclosures on the front and the reverse sides of a page.

In the staff's opinion, the language "single written statement" does not mean that the initial open end credit disclosures required by § 226.7(a) must be placed on the same side of a single sheet of paper. Consequently, a creditor would not be prohibited from using the front and the reverse sides of "a single written statement."

In accordance with your request, this is an official staff interpretation issued pursuant to § 226.1(d)(2) of Regulation Z, as revised on April 21, 1978. It will become effective thirty days after it is published in the Federal Register, unless the Board receives an appropriate and timely request for public comment. You will be promptly notified if such a request is received.

I note that you may represent creditors subject to the laws of the State of Connecticut. Since Connecticut has been granted an exemption from the applicable provisions of the Truth in Lending Act, you may wish to contact the office of Mr. David H. Neiditz, Bank Commissioner of the State of Connecticut, for his views.

I trust that these official comments satisfactorily answer your inquiry. If you have other questions in the future, please feel free to contact Mr. Edward F. Kipfstuhl, Manager, Consumer Affairs and Regulations Department, at the Federal Reserve Bank of New York, New York, New York 10045.

Sincerely,

Nathaniel E. Butler
Associate Director

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

DIVISION OF CONSUMER
AND COMMUNITY AFFAIRS

February 1, 1980

12 CFR Part 226, FC-0170

Dear

This responds to your letters requesting an official staff interpretation regarding the disclosure of the cost of voluntary credit disability insurance in open-end credit plans.

You state that, in certain cases, the disclosure of the cost of disability insurance is extremely lengthy and complex and that the cost disclosure is included on the § 226.4(a)(5) authorization in order to exclude the insurance premiums from the finance charge. You question, however, whether the cost disclosure must also appear as a § 226.7(a)(6) "other charge" with the initial disclosures required by § 226.7(a). You point out that Public Information Letter 1037 seems to indicate that disclosing the cost only on the § 226.4(a)(5) authorization would not suffice for purposes of § 226.7(a)(6) and that the cost should also appear with the initial disclosures.

Section 226.7(a) requires that all of the initial disclosures for an open-end credit plan appear "in a single written statement." This does not mean, however, that all the initial disclosures must appear on one single sheet of paper. Rather, they may appear on several sheets or pages, provided that these sheets or pages constitute an integrated document (for example, a brochure, a stapled document, or a document whose pages are numbered sequentially or which clearly evidences in some other fashion that the pages are part of the same document). Therefore, in your case, as long as the initial disclosures and the § 226.4(a)(5) authorization (on which the cost disclosure appears) constitute an integrated document, the cost disclosure satisfies the requirements of both § 226.4(a)(5) and § 226.7(a)(6). Letter 1037 is modified to the extent that it appears to indicate otherwise. Of course, where the initial disclosures are made on more than one sheet of paper, special attention should be paid to insure that the disclosures are clear, conspicuous, and in meaningful sequence as required by § 226.6(a).

This is an official staff interpretation of Regulation Z, issued pursuant to § 226.1(d)(2). It is limited to the facts and issues discussed herein. It will become effective 30 days after publication in the Federal Register unless a request for public comment, made in accordance with the Board's procedures, is received and granted. We will notify you if the effective date of the interpretation is suspended because such a request is received.

Sincerely,

Nathaniel E. Butler

Nathaniel E. Butler
Associate Director

NO. 120

360 VS 365 DAYS--CREDIT UNIONS

September 19, 1969

Before a finance charge or an annual percentage rate can be calculated, it is necessary that the period on which these charges or rates are based must be determined. In this regard, a "period" has been defined in Section 226.2(d) of Regulation Z as meaning "a day, week, or other subdivision of a year." Therefore, there are 12 monthly periods in a year, 52 weekly periods in a year and 365 daily periods in a year. On the basis of this definition, finance charges may be assessed on the basis of 12 monthly "unit periods" per year, but may not be assessed on the basis of 360 daily "unit periods" in a year, since 360 days does not meet the definition of a "period" as stated above. If finance charges are to be assessed on a daily basis, each day should be considered as 1/365th of a year.

The basic difference between your position and a position stated in the Accounting Manual for Federal Credit Unions apparently seems to be the determination of how the finance charge is to be computed for a period of less than 30 days when a monthly "unit period" is used. To accommodate this computation, we have taken the position that when a fraction of a monthly period is involved, the computation should be based on the actual number of elapsed days in that fraction as that number relates to 30. We have advised the Bureau of Federal Credit Unions accordingly so that instructions issued in the Accounting Manual for Federal Credit Unions may be in accord with the position we have taken.

We believe that using the number of actual elapsed days during a fraction of a monthly period is a realistic method of computing the finance charge. All persons who are paying a finance charge for a fraction of a monthly period are treated alike. The same charge is assessed for the same number of days regardless of whether the fraction of the monthly period fell during a month or encompassed a month-end that contained 31, 30, 29, or 28 days.

Sincerely yours,

Frederic Solomon,
Director

NO. 134

ADVERTISING—"UP TO TWO YEARS TO PAY" "A SMALL MONTHLY SERVICE CHARGE ON THE REMAINING BALANCE" "SPREAD THE PAYMENTS FOR AS LONG AS 24 MONTHS"

October 16, 1969

1. Whether a particular advertisement falls within Section 226.10(c) Advertising of open-end credit or Section 226.10(d) Advertising of credit other than open-end, which implement the corresponding statutory provisions, depends upon the character of the particular plan being advertised. If that plan meets the definition of open-end credit in Section 226.2(f) the advertisement would be governed by Section 226.10(c). If it does not meet that definition it would be subject to Section 226.10(d). Study of the credit plan itself should reveal whether it meets the tests of Section 226.2(r). The fact that a particular customer chooses only to finance a single transaction under the plan would not necessarily affect its characterization. We will be happy to consult with you as to the proper category under Regulation Z applicable to a particular plan.

2. If the underlying credit plan meets the definition of Section 226.2(r) for open-end credit it would be permissible to advertise "up to two years to pay" without stating additional terms under Section 226.10(c). The prohibition against giving "the time period, if any, within which any credit extended may be paid without incurring a finance charge" without additional terms relates to the normal "free-ride" period in an open-end account and not to the total term of the credit extension.

On the other hand, it would not be proper to advertise "up to two years to pay" by itself for a plan which is not open-end credit as defined by Section 226.2(r). Section 226.10(d) specifically provides that one may not advertise "the period of repayment" without giving additional information.

3. In our opinion the advertisement of "a small monthly service charge on the remaining balance" is a statement of either "the conditions under which a finance charge may be imposed" or "the method of determining the balance upon which a finance charge may be imposed," which are credit terms specified in Section 226.7(a), and consequently the advertisement would trigger Section 226.10(c) and all terms would have to be stated.

4. In our opinion the prohibition in Section 22 226.10(c) against stating that "a specified periodic payment is required" without stating additional terms would not enconpass the phrase "spread the payments for as long as 24 months."

Sincerely yours,

Frederic Solomon,
Director

No. 281

360 vs 365 days

March 11, 1970

To our knowledge, there is no uniform requirement that financial institutions which compute interest on the basis of the actual number of days apply a factor based on a 365-day year in making these computations. We are aware that the regulatory agencies of some financial institutions do not allow the imposition of interest based on the exact number of days in the term of the loan when it is calculated by means of a 360-day factor if that financial institution is charging the maximum interest rate allowable by law. Under those circumstances, the interest so computed would be greater than is allowed by Law.

However, the Truth in Lending Act now sheds new light on this practice. Disclosures required by that Act must include an annual percentage rate which reflects a relationship between the amount financed and the finance charge. In this connection, we refer you to the definition of "period" as stated in Section 226.2(t) of Regulation Z, and, which can be found on page 5 of the white section of the enclosed pamphlet, "What You Ought to Know About Federal Reserve Regulation Z." From this definition you can see that the period on which finance charges are based, and annual percentage rates are calculated, is defined as a "day, week, month, or other subdivision of a year." Therefore, if a finance charge is assessed on a daily basis, there would be 365 such periods in a year, and it would be inaccurate to quote an annual percentage rate based on 360 day year. If a creditor stated an annual percentage rate based on a daily method of computing interest, but actually computed interest on some other method which resulted in an inaccurate disclosure of an annual percentage rate when rounded to the nearest quarter of a per cent, such inaccuracy would be considered a violation of the Truth in Lending Act.

We believe that the Truth in Lending Act requiring creditors to disclose their credit terms in uniform terminology results in placing credit on a competitive basis. With this information, consumers should have the facts necessary to make intelligent credit comparisons and thereby avoid the uninformed use of credit.

Very truly yours,

Kenneth A. Kenyon
Deputy Secretary

No. 327

Sec. 226.2(g) Period between credit union statements
Sec. 226.7(b) " " " " "

May 20, 1970

This is in response to your letter in which you presented a question as to the frequency with which credit unions should furnish periodic statements in connection with open end credit accounts as required by Section 226.7(b) of Regulation Z.

You point out that because of the nature of credit union operations, "billing cycles" as defined in Section 226.2(g), have not been used. Traditionally, credit unions have not billed for payments due. They assess finance charges only when payments are made. For these reasons, statements reflecting the transactions in the account for the preceding quarterly period (or in some cases, semiannual) have been used by credit unions rather than any system encompassing a billing cycle and a billing statement. Since the advent of Truth in Lending, the statement of account forms have been altered to reflect the applicable disclosures required by Section 226.7(b).

The philosophy behind the requirements under Section 226.7(b) for periodic statements is that the creditor should provide the customer with regular statements setting forth the information required to be disclosed under that paragraph. The purpose is to remind the customer frequently of the Truth in Lending disclosures.

In those instances where an open-end credit plan does not embrace a typical billing cycle, as such, under the literal terms of Section 226.2(g), the creditor may be able to set the period of the cycle for Regulation Z purposes at whatever interval he chooses to send statements. However, creditors should be compelled to furnish the information required by Section 226.7(b) at a frequency consistent with the spirit of the Truth in Lending Act. Statements of quarterly frequency would certainly provide greater consonance with the spirit of the Act than would statements of lesser frequency. Accordingly, we are giving thought to clarifying the regulatory language to limit specifically the frequency of disclosures required by Section 226.7(b) to periods not longer than quarterly.

Sincerely yours,

Frederic Solomon
Director

No. 391

Sec. 226.10(d) Maximum terms of Federal Land Bank and Production Credit Association Loans

Jun 3, 1970

Regarding the advertisement of maximum terms (in years) of loans which may be made by Federal Land banks and production credit associations: Specifically, you asked that we clarify whether such institutions may advertise maximum loan terms specified by statute without advertising any other credit terms.

Inasmuch as paragraph (d) of Section 226.10 of Regulation Z provides that " ... the number of instalments or the period of repayment ... " shall not be advertised unless other terms are also advertised it is clear that on the basis of the opening phrases of that paragraph, if the publication of maximum repayment terms are intended to aid, promote, or assist directly or indirectly the extension of consumer credit, such advertisement must also include the terms enumerated in Section 226.10(d)(2)(i) through (v), inclusive.

Milton W. Schober
Assistant Director

No. 467

REQUIREMENT THAT APR IN ADVERTISING PRINTED CLEARLY AND CONSPICUOUSLY—ADDITIONAL INFORMATION NOT TO MISLEAD OR CONFUSE CUSTOMER OR CONTRADICT OR OBSCURE RATE
Sec. 226.6(a)
Sec. 226.6(c)
Sec. 226.10(d)(1)

March 30, 1971

This is in reply to your letter regarding the applicability of Section 226.6(a) and Section 226.6(c) of Regulation Z to advertisements under Section 226.10(d)(1).

In our view, the provisions of Section 226.6 (a) and (c) require than under Section 226.10(d)(1) the annual percentage rate be printed clearly and conspicuously, and that other information not be used in a manner to mislead or confuse the customer, or contradict or obscure the disclosure of the rate.

Griffith L. Garwood,
Attorney

No. 534

MESSAGES ON CHECKING ACCOUNT STATEMENTS
Sec. 226.2(b)
"GET AN AUTO LOAN OF 9.25 ANNUAL PERCENTAGE RATE"
ON CHECKING ACCOUNT STATEMENT
Sec. 226.10(d)

October 22, 1971

This is in response to your letter questioning whether certain information placed on a customer's checking account statement would be classified as an advertisement under Regulation Z.

The definition of advertisement, as stated in Section 226.2(b) of Regulation Z, is quite broad in that it includes any commercial message. This definition, combined with the provisions of Section 226.10 dealing with the advertising of credit terms, basically places any message to aid, promote, or assist directly or indirectly any extension of consumer credit as an advertisement coming within the scope of the Regulation. Consequently, we believe that any message promoting consumer credit placed on the bank statement would be an advertisement subject to the Regulation.

We believe that continued use of the "add-on" or "discount" rate in place of, or in conjunction with, the annual percentage rate, merely tends to perpetuate the confusion which Truth-in-Lending was intended to cure. Consequently, we have taken the position that the use of the "add-on" or "discount" rate is not permissible.

I would be permissible under the Regulation to place the statement "Get an auto loan for 9.25 Annual Percentage Rate" on the checking account statement. Section 226.10(d) of Regulation Z permits a creditor to advertise the annual percentage rate alone without including the other credit terms in credit plans that are other than open end.

No. 651

EFFECT ON CHARACTERIZATION OF PLAN OF VARIOUS METHODS OF COMPUTING MINIMUM PAYMENT
Sec. 226.2(r)

DISCLOSING MINIMUM PERIODIC PAYMENT
Sec. 226.7(a)

APPLICABILITY OF "RANGE OF BALANCES" REQUIREMENT WHEN SINGLE PERIODIC RATE USED
Sec. 226.7(a)
Sec. 226.7(b)

December 15, 1972

This is in response to your letter of October 27, and letter of September 28, 1972, relating to proposed adjustments in the programs of members. Specifically, you inquire whether certain alternatives in computing the minimum payment due may remove a credit plan, which otherwise meets the definition of "open end credit" in §226.2(r) of Regulation Z, from that category.

Under one alternative, the minimum payment is the greater of a percentage of the outstanding balance or a specific dollar amount. Under the second alternative, the minimum payment is a fixed dollar amount regardless of the outstanding balance of the account. Under the third alternative, the minimum payment is based on a fixed dollar amount to which is added any finance charges imposed on the account during the billing cycle. For example, if a finance charge of $4.50 is imposed during the billing cycle, and $50 is the fixed element of the minimum payment, the minimum payment due for that billing cycle would be $54.50. We understand that the various alternatives are proposed to be used by the different banks that are members of your association.

Under §226.2(r) of Regulation Z, open end credit is defined to include plans which provide that the customer has the privilege of paying the balance in full or in instalments. The definition does not prescribe the method by which the instalments must be determined. Consequently, it is staff's opinion that these alternative methods of computing the minimum periodic payment would not disturb a credit plan's designation as "open end credit."

As an associated question you ask whether the disclosures suggested in your letter of October 27 would meet the requirements of §226.7(a)(8) relating to "the minimum payment required." It is staff's opinion that this provision does not require that specific dollar amounts of payments be shown. We believe that this requirement can be met by disclosing the method by which the periodic payments would be determined, and that you have done so adequately.

We note that you propose to show the amount of the average daily balance under the alternative plan as the "range of balances" when there is a single periodic rate. The range of balance disclosure was intended to show the break point where there was more than one rate applicable to the account. (See §127 of the Act.) In our view the range of balance disclosure is not "applicable" to a single rate account and is therefore not required under either §226.7(a) or §226.7(b). Moreover, even if it were applicable that the periodic rate was simply applicable to the account balance—the range implicitly would be the entire range of balances under the account.

Griffith L. Garwood
Chief, Truth in Lending Section

No. 666

§ 226.7 Necessity for showing total finance charge.

January 30, 1973

In your letter of January 19, 1973, you questioned whether the disclosure of finance charges on statement is in compliance with Regulation Z. The statement provides separate accounting for purchase and cash advance portions of the account and also provides combined totals for purchases and advances, but does not show a total finance charge figure including both the products of the periodic rates and the per item charge on cash advances. The question is whether such a total is required. The disclosure in question is made as follows:

	FINANCE CHARGE	
	At periodic rate	Per item
Purchases.		▨
Advances.		
Total.		

The "per item" column includes transaction charges for cash advances at the rate of 25¢ per cash advance.

It is staff's opinion that the disclosure of the finance charges under the method outlined meets the provisions of § 226.7(b)(4) of Regulation Z. Under that section each element of the finance charge must be itemized and identified. There is no requirement under open end credit that these various elements must be added together and a total of the finance charges disclosed, as there is for credit other than open end. (See § 226.8(c)(8)(i) and § 226.8(d)(3)).

Very truly yours,

Griffith L. Garwood
Chief, Truth in Lending Section

No. 670

§ 226.6(c) Meaning of "10 point type"

February 13, 1973

This is in response to your letter of January 24, 1973, relating to § 226.6(c) of Regulation Z which requires the disclosure of certain printed numerical amounts in "not less than the equivalent of 10 point type. . ." You indicate that your research has not resulted in determining precisely what constitutes 10 point type.

It is staff's understanding that "points" used in printer's terminology indicate the size of the body of the type. A point is 1/72 of an inch and, consequently, 10 points are 10/72 of an inch. The body of the type is the metal slug upon which the type face is positioned. A slug measuring 10/72's of an inch is 10 point type. Put another way, on a printed page, the measurement from the bottom of a lower case letter to the bottom of the same lower case letter in the line immediately above the measured letter must be 10/72 of an inch in order to be 10 point type.

The type face (or the size of the printed letter or numeral) legitimately may vary between various print manufacturers. However, it is a general rule that the larger the point size, the larger the size of the type face of the printed letters or numerals.

I hope this information is of assistance to you.

Very truly yours,

Griffith L. Garwood
Chief, Truth in Lending Section

No. 689

§ 226.7(b) Treatment of adjustment "debits"

June 1, 1973

This is in response to your letter of December 1, 1972, requesting a Board interpretation under Regulation Z with regard to the proper method of disclosing "debits" on periodic statements made primarily to correct mispostings and to adjust for checks returned for insufficient funds. You indicate that creditors are presently either netting "debits" and "credits" and disclosing the resulting total under a "credits" heading, or disclosing "debits" and "credits" separately along with a brief identification of the item giving rise to the debit.

As you indicate, Section 127(b) of the Truth in Lending Act does not deal with the disclosure of debits of the type described. Likewise, § 226.7(b) does not require any specific disclosures with regard to such debits. Moreover, it is our view that the § 226.7(b)(3) requirement of showing "adjustments" under the term "credits" would permit any creditor to show a net adjustment in the "credits" column, or, as an alternative, separately disclose adjustment "debits" and adjustment "credits."

Since Regulation Z, as well as the Act, is silent on the specific handling of such debits, we believe that the creditor has considerable flexibility in how they may be shown on the periodic statements, and the various methods desctibed in your letter would be permissible.

Very truly yours,

Griffith L. Garwood
Adviser

No. 780

§ 226.6(a) General discussion of "clear" and "in meaningful sequence"
§ 226.6(c) Inclusion of additional information with the disclosures

April 10, 1974

This is in reply to your letter dated March 15 asking for answers to the following documentation questions which are restated below in the order submitted, followed in each case by an opinion of the Board's staff.

> _One_, whether a statement of the buyer's obligation in contractual form or of the agreement of the parties to sell and to purchase may _precede_ the disclosures required by Regulation Z.

As regards the placement of terms in the contract, the contractual provisions of the obligation may precede or follow the disclosures required under Regulation Z, or the required disclosures may be embodied in the contractual provisions. In any case, the disclosures required must be made in accordance with § 226.6 and other applicable sections of Regulation Z. The objective is to furnish the customer a clear and meaingful disclosure of the credit terms and other information in respect to the transaction. It would be quite difficult to design an all-purpose type of disclosure statement and contract which will, in every case, satisfy the objectives. The type of presentation of disclosures will depend upon the complexity of the transaction and the ingenuity of the designer of the disclosure form.

> _Two_, whether the making of a required disclosure in contractual terms, on the assumption that it will thus suffice both as a disclosure and a contractual provision, is permissible under Regulation Z.

Again, it is not possible to answer the question without qualification. There are some types of transactions which, by reason of their simplicity, might be susceptible to disclosure in the manner suggested. Others may be too complex and require separate disclosures to meet the requirements of § 226.6 and other applicable provisions of Regulation Z.

> Three, whether the intermingling of required disclosures with contractual provisions not required by Regulation Z to be disclosed is permissible under the Regulation and particularly Section 226.6(c) providing that "At the creditor's option, additional information or explanation may be supplied with any disclosure required by this part, but none shall be stated, utilized or placed so as to mislead or confuse the customer or contradict, obscure, or detract attention from the information required by this part to be disclosed."

It seems to us that the requirements of § 226.6 of Regulation Z are clear. While, in some cases, intermingling of contractual provisions with disclosures may be accomplished without conflict with § 226.6(a) and (c), it would not be correct to say it can be done without conflict in every case.

> Four, whether a given disclosure made in response to the requirements of Regulation Z is made in the "meaningful sequence" required by Section 226.6(a)--for example where disclosure of the method of computing rebage on prepayment precedes all other required disclosures.

We see no reason why a creditor making the disclosures required under § 226.8(b)(7) of Regulation Z ahead of other required disclosures would be considered in violation of § 226.6(a) as long as all disclosures required are made together and in accordance with other applicable provisions of the Regulation.

The words "in meaingful sequence" in § 226.6(a) relate to a presentation of required disclosures in a logical order with respect to those items which have an arithmetical relationship to each other. For example, many of the items called for in § 226.8(b), (c) and (d) are arithmetical and follow each other in logical progression. The remaining items are informative and have no particular interdependence. A meaningful sequence would call for those items which are arithmetically related to appear within a reasonable proximity to each other, not mixed with items which are irrelevant to a progression of arithmetical computations or thought.

We realize that it is not always practical to list the items in vertical order, but in keeping with the purpose of the Truth in Lending Act, they should be placed in reasonable proximity to each other so that the customer will not be required to search for any arithmetical items which should logically follow a previous one.

We are sorry that we are unable to give you categorical answers to your questions. Hopefully, the foregoing opinions should provide some guidance in evaluating forms for your clients. For reasons which may be apparent in the foregoing discussion, the Board and its staff have refrained from giving general approval of disclosure forms other than those examples of forms set forth in the Board's pamphlet, "What You Ought to Know About Federal Reserve Regulation Z." Generally, credit sales are made by creditors under the enforcement responsibility of the Federal Trade Commission. If you have problems concerning the adequacy of disclosure forms of such creditors, we suggest that you communicate with the Commission for assistance.

Sincerely,

Jerauld C. Kluckman
Chief, Truth in Lending Section

No. 793

§ 226.7(b) Minimum frequency of periodic billing statements in an open end account

May 14, 1974

This is in response to your letter of May 7 in which you questioned whether periodic billing statements of semi-annual frequency in an open end credit plan would satisfy the requirements of Regulation Z. You point specifically to letter number 327 issued by staff on May 20, 1970, which dealt with the topic of billing statement frequency for credit unions with open end credit plans. That letter concluded that any frequency less than quarterly in the issuance of such billing statements may not be in compliance with the spirit of the Truth in Lending Act.

Under the open end disclosure concept, certain disclosures are made initially under § 226.7(a) before the account is opened. In addition, however, there is a second stage disclosure which is required by § 226.7(b) on the periodic billing statements. Staff is of the opinion that the disclosures on the periodic billing statement are extremely important to the whole disclosure concept of open end credit and, consequently, must be made with some frequency to serve the purposes for which they were intended. We believe that quarterly disclosure as specified in our letter number 327 is about minimum frequency at which such statements can effectively serve the disclosure purposes for which they were intended.

We understand that credit unions have followed the direction of letter 327 and, therefore, the cautionary note in that letter with respect to amending the Regulation to formalize the position in the letter has not at this point seemed to be necessary.

Sincerely,

Jerauld C. Kluckman
Chief, Truth in Lending Section

No. 837

§ 226.6(c) and (f) In issuing a bank draft, a creditor must disclose the credit charges specifically related to the amount of the draft. Hypothetical disclosures tied to lesser amounts is permissible as are subsequent disclosures related to the actual amount financed

§ 226.8(a) " " " "

September 3, 1974

This is in response to your letter of August 19, requesting staff opinion of proposed disclosures in connection with the issuance of bank drafts for a specified amount which may be used to purchase an automobile in the future. You propose to make the required Truth in Lending disclosures based upon the amount of the bank draft at the time the draft is issued. In addition, you propose to provide the customer with a schedule giving disclosures for amounts less than the full amount of the draft in increments of $200. Once the draft has been used to purchase the automobile, the bank will then provide the customer with the exact Truth in Lending disclosures for the amount of money borrowed.

Section 226.8(a) of Regulation Z requires that specific disclosures for credit other than open end be made before the transaction is consummated. It is staff's opinion that consummation, for purposes of Regulation Z, would be at the time the draft is issued in the plan you described. Therefore, the lender should make the required disclosures based upon the full amount of the draft at the time the draft is issued. These disclosures should be identified as estimates, where applicable, under the provisions of of § 226.6(f). In addition, staff believes that your proposed additional disclosures for lesser amounts would be appropriate and would not violate § 226.6(c). Finally, staff believes that it would be of value to the consumer to provide him with additional disclosures of the exact terms when the draft is used.

Sincerely,

Jerauld C. Kluckman
Chief, Truth in Lending Section

No. 846

§ 226.7(a) Required share account balance must be disclosed as a security interest in open end credit plan; if a specific amount of balance is pledged, it should be identified

October 9, 1974

This is in response to your letter of September 24, concerning the proper disclosure of a credit union open end credit plan which requires its members to maintain a specific dollar amount share account balance as a condition of granting the credit. The contract provision relating to this account balance states:

> "In the event of default, the undersigned hereby pledges any shares, deposits or payments on shares now or hereafter held by the undersigned in this credit union as additional security for the payment of this obligation and hereby authorizes the credit union to apply any or all of such shares, deposits, or payments on shares for the payment of this loan, interest, costs or expenses."

It is staff's opinion that this type of required share account balance must be disclosed under § 226.7(a)(7) of Regulation Z, which deals with disclosure of security interests in open end credit. When a specific amount of a share account is pledged, staff believes that the amount of the pledged shares should be identified. I have enclosed staff opinion letter 827, which deals with a similar situation in closed end credit.

You question whether the provisions of § 226.8(e) governing "required deposit balances" would be applicable in this instance. It is staff's opinion that the required deposit balance provisions of § 226.8(e) apply only to other than open end credit and would not be applicable in an open end credit situation.

Sincerely,

Jerauld C. Kluckman
Chief, Truth in Lending Section

No. 849

§ 226.2(b) (f) and (m) The publisher or distributor of a pamphlet containing mortgage information is not an arranger of credit unless he receives remuneration for services from a lender or participates in the preparation of credit documents. Nonetheless, such information would be considered an advertisement under the Act, if it is disseminated to the public
§ 226.10 " " " "
§ 226.1001 " " " "

October 17, 1974

This is in further reference to your letter dated August 16, concerning the application of Regulation Z to published "Mortgage Information" distributed to members, brokers, and salesmen, and certain financial institutions by a residential real estate multiple listing bureau. The information provided includes certain mortgage lending terms and sets forth the names of certain creditors who furnish information to the bureau and their respective credit terms. The published information does not identify its distributing terms. The published information does not identify its distributing source, and the material is distributed for use by members, brokers, salesmen, and financial institutions; but you indicate that it might be displayed from time to time by such persons to interested customers.

You ask whether the issuing multiple listing bureau, its members, brokers, or salesmen, or the institutions which supply the information would be "arrangers" of credit under § 226.2(f) of Regulation Z, and whether the advertising provisions of § 226.10 would apply to such publications.

Under § 226.2(f), "arrange for the extension of credit" means to provide or offer to provide consumer credit which is or will be extended by another person under a business or other relationship pursuant to which the person arranging such credit receives or will receive a fee, compensation, or other consideration for such service or has knowledge of the credit terms and participates in the preparation of contract documents required in connection with the extension of credit." (Emphasis supplied) In the opinion of our staff, unless a multiple listing bureau or user of this publication receives a fee or other consideration under a business or other relationship with the lender for services in arranging for the extension of credit or, having knowledge of the credit terms, participates in the preparation of the credit documents, such a person would not be an "arranger" under § 226.2(f).

It is important to note that the provisions of § 226.10 regulating credit advertising are not limited to advertisements by "creditors" or "arrangers of credit" as defined in § 226.2(m) and (f) of the Regulation. Therefore, whether or not members, brokers, salesmen, or institutions which supply the information would be "arrangers" for purposes of § 226.2(f), such persons would still be subject to the requirements of § 226.10 governing advertisement of credit.

Determining the status of the publication with respect to the application of § 226.10 is very difficult. The requirements of § 226.10 apply to any advertisement, as defined in § 226.2(b), to aid, promote, or assist directly or indirectly any extension of consumer credit, whether such advertisement is made by a creditor or by any other person. If your publication is used solely as an "in-house" information sheet by realtors, then it would seem that the advertising provisions would not apply to it. On the other hand, if you are aware that your publication is used as a form of credit advertisement by realtors by virtue of the fact that they make it available to consumers, then the information required under § 226.10 should be included in your publication. If the requirements are applicable, examples of typical financing may be used. (See § 226.1001.)

Sincerely,

Jerauld C. Kluckman
Chief, Truth in Lending Section

No. 876

§ 226.7(a) Creditor must disclose either the amount or method of determining the amount of minimum payment when it is subject to fluctuation in relation to outstanding balance

February 27, 1975

I am writing in response to your letters of . . . concerning the necessary minimum periodic payment disclosure required by § 226.7(a)(8) of Regulation Z. This staff concurs with the view taken in your letter to . . . concerning the need for a creditor to disclose either the amount or method of determining the amount of minimum payment when it may fluctuate in relation to the outstanding balance in the consumer's account.

In our view, such a disclosure is implicit in the requirement of § 226.7(a)(8), and we have found that open end creditors commonly disclose the fluctuations in the minimum payment (such as $10 minimum payment for unpaid balances up to $100 and $20 for unpaid balances in excess of $100 as is cited in the example contained in your letter of . . .). We believe that such a disclosure is required in connection with . . . preferred revolving credit agreement.

Sincerely,

D. Edwin Schmelzer
Fair Credit Practices Section

No. 894

§ 226.7(b) **Permissible to identify each payment and each credit as such and to total all payments and credits in a joint payments/credits box. Also permissible to identify payments separately and credits separately in that portion of the billing statement in which transactions are described.**

May 19, 1975

This is in response to your letter ..., with respect to questions regarding the disclosure of payments and credits under § 226.7(b)(3) of Regulation Z. Specifically, you posed the following questions; our responses immediately follow those questions.

1. May we identify each payment as such, and each credit as such, each individually, and then have the total of all payments and credits combined and disclosed in a joint payments/credits box?

Staff believes it is permissible under Regulation Z to identify each payment and each credit as such and to have a total of all payments and credits combined and disclosed in a joint payments/credits box.

2. Is there a Board purpose to be served by separate identification of each credit as "credits" and each payment as "payments," or in the interest of meaningful disclosure, may we identify each credit as "credit" and each payment as "payment?"

It is staff's view that it would be permissible to identify each payment as "payment" and each credit as "credit" as opposed to "payments" and "credits." While the technical language of the regulation would seem to require the terms "payments" and "credits," staff believes that such terms are perhaps more appropriate for column headings as opposed to line entries.

3. Is it permissible to identify payments separately and credits separately in the transaction description portion of the billing statement?

Staff believes it would be permissible to identify payments separately and credits separately in the portion of the billing statement in which transactions are described.

Sincerely,

Jerauld C. Kluckman
Chief, Fair Credit Practices Section

No. 994

§ 226.6(a)	Billing rights statement under § 7(a)(9) is not subject to "more conspicuous" requirements of § 6(a) but must comply with numeral type size requirements of that section
§ 226.7(a)	" " " " "
§ 226.7(b)	Credits shown in same column as payments on periodic statement must be separately identified
	Periodic statement must be sent at least 14 days before end of any free-ride period shown on statement
§ 226.7(j)	Checks issued payable to customer in response to loan request under revolving credit loan account are not subject to provisions of § 7(j)

January 20, 1976

This is in reply to your letter . . . , concerning questions you have about the recent amendments to Regulation Z, implementing the Fair Credit Billing Act. You ask several questions and, to the extent possible, I will answer them in the order in which they were presented.

1. On your periodic statement there is a column headed "Payments Credits." There is also a column with the heading "Code." At the bottom of the periodic statement is a listing of the code symbols by which an item which appears in one of the other columns is described in the "Code" column. For example, if a payment appears in the "Payments Credits" column, the code symbol "Paym" appears on the same line in the "Code" column and the customer is told by referring to the listing at the bottom of the periodic statement that this indicates a payment received. However, as staff understands your periodic statement form, there is no similar code symbol for other credits which may appear in the "Payments Credits" column. Your question is whether this is sufficient under § 226.7(b)(1)(iii) of Regulation Z or whether separate columns for payments and credits must be provided or, alternatively, whether each credit must be separately identified as such in the "Code" column.

In staff's view, it is permissible under the regulation to have payments and credits in the same column with each identified as either a payment or a credit or to provide separate columns, one for payments and one for credits. The system which you use currently identifies the payments but leaves the credits unidentified except by a process of elimination. That is, any figure which appears in the "Payments Credits" column which is not otherwise identified would have to be presumed to be a credit by the customer. In staff's view, this is not a sufficient disclosure. However, we believe that compliance with the regulation could be achieved by an abbreviated code reference to credits.

2. On your periodic statement you state that there is a provision which says "Please make minimum payment of $__________ within 10 days after above closing date of billing cycle to avoid additional charges." You state that you have changed the reference to read "14 days" but had not done so on the periodic statements mailed on November 10, 1975, your statement mailing date (which coincided with the closing date of your billing cycle). You ask whether this was improper under § 226.7(b)(2) and, if so, what your bank should do in order to comply.

To begin, I should point out that not only § 226.7(b)(2) but, also, § 226.7(b)(1)(ix) has an impact upon your practice in this regard. Section 226.7(b)(2) requires that the periodic statement be mailed or delivered at least 14 days prior to the date specified in the statement as being the date by which payment of the new balance must be made in order to avoid the imposition of an additional finance or other charge. This section, of course, applies only in those cases in which such a date exists. Failure of the creditor to comply with this provision results in the creditor's forfeiture of finance charges for that billing cycle. Evidently, your bank does contemplate such a date because it does provide that the customer may pay the minimum payment within 10 days (to be changed to 14 days) to avoid additional charges.

Section 226.7(b)(1)(ix) provides that the date by which or the period within which, if any, payments must be made to avoid additional finance charges must be disclosed. Obviously, this date must be at least 14 days after the periodic statements are mailed in order to comply with § 226.7(b)(2). Therefore, in staff's view, the disclosure of the 10-day period in November apparently was not in compliance.

3. You ask whether, if your periodic statement contains only one address, the provisions of § 226.6(k)(2) would require you to change your periodic statement to comply with § 226.7(b)(1)(ix).

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Section 226.7(b)(1)(x) requires that an address preceded by the caption "Send Inquiries To:" or similar language be supplied on each periodic statement. Section 226.6(k)(2) provides that if there is more than one address listed on a periodic statement, then any billing inquiry received at either of those addresses would have to be treated as a proper written notification of a billing error, assuming all other elements of a proper written notification are present, unless one of the addresses was preceded by the caption or other similar language. Section 226.6(k)(2) further provides that a periodic statement will be deemed to be in compliance without a caption as provided in § 226.7(b)(1)(x) until April 30, 1976, if it has only one address listed. Any notifications of billing errors received at that address must, of course, be treated as a proper written notification of a billing error. After April 30, 1976, at least one address on the periodic statement must contain the prescribed caption or similar language. Section 226.6(k)(2) was designed as a transition period to allow creditors to design and print complying forms without depriving customers the facility through which to raise inquiries.

4. You state that an affiliate corporation of your bank, a consumer finance company, is considering establishing revolving credit loan accounts in connection with which they would pay out funds by issuing their check payable to their customer. You ask whether such a check comes under the definition of "supplemental credit devices" or "payee designated check" for purposes of § 226.7(j).

As staff understands the situation, the checks in question are simply the finance company's method of providing funds under a requested loan. These checks are payable to the customer and could be used by him in whatever manner he chooses. Presumably, at the time of opening the account or at the time of application for the loan the relevant Truth in Lending disclosures were made. Under this characterization of the situation, it is staff's view that the check which is issued to the customer is not a "supplemental credit device" or "payee designated check" as contemplated by § 226.7(j).

5. You state that you have some concern with the instructional wording at the beginning of Appendix C on page 91 of the Truth in Lending pamphlet of October 28, 1975. Your concern is that the wording appears to require compliance with the "more conspicuous" requirements and the numeral type size requirements of § 226.6(a). Further, you indicate that the statements for purposes of §§ 226.7(a)(9) and 226.7(d)(5), set out in Appendix C, do not comply with § 226.6(a) and that you are therefore unsure whether the apparent requirement that § 226.6(a) be followed is in fact the right inference to draw from that language.

In staff's view, the requirement that the term "finance charge" be more conspicuously disclosed in those cases where it is a required term under the regulation does not apply to this statement. The requirement in § 226.6(a) was directed at those cases, such as § 226.7(b)(1)(iv), where the term "finance charge," as such, is required. It is staff's belief that the numeral type size requirements of § 226.6(a) are, in fact, met by the statement as set out in Appendix C and should be met in any such statements which are prepared by creditors. To add to this discussion, I am enclosing two earlier staff opinion letters outlining when the "more conspicuous" requirement of § 226.6(a) must be met.

Sincerely,

Jerauld C. Kluckman
Assistant Director

No. 1037

§ 226.4(a)(5)	Credit life insurance disclosures for open end plan may be made on separate statement but cost must be shown on § 7(a) disclosures as an other charge.
§ 226.7(a)	" " " " "
§ 226.7(b)	Accrued monthly insurance charge must be identified in same way as other § 7(b)(1)(ii) amounts.

April 22, 1976

This is in reply to your letter of . . . , in which you raised questions about the proper treatment of the insurance authorization under § 226.4(a)(5) of Regulation Z for open end credit plans.

The first concern expressed in your letter is whether the disclosures and authorization required by § 226.4(a)(5) may be made on a document other than the disclosure statement containing the § 226.7(a) disclosures. In staff's view, it is permissible to make the § 226.4(a)(5) disclosures for open end credit on a document separate from the § 226.7(a) disclosure statement. Since under your client's credit program the amount and cost of insurance will depend upon the amount of credit extended, the requirement in § 226.4(a)(5) that the cost of the insurance be disclosed would be satisfied by a disclosure of the amount of the insurance premium applicable to a given amount of credit extended (e.g., 24 cents per hundred dollars).

With regard to your second question, in staff's view the insurance premium is an "other charge" under § 226.7(a)(6) and must be disclosed as such. This is true even though the cost of the credit insurance has been disclosed on the separate written authorization pursuant to § 226.4(a)(5).

You ask what additional disclosures the bank would have to make using a separate document for the insurance authorization, assuming the bank were to treat the insurance premium accruing at the end of each billing cycle as a loan advance upon which a finance charge will begin to accrue in the next billing cycle. In staff's view, the reflection on a periodic statement of an amount charged to a customer's account for the insurance premium should be identified in the same manner as any other credit transaction reflected on the account under § 226.7(b)(1)(ii). This, staff believes, is true whether or not a finance charge is imposed upon that amount.

I trust this is responsive to your inquiry.

Sincerely,

Glenn E. Loney
Attorney
Fair Credit Practices Section

No. 1044

§ 226.8(n) Quarterly credit union statement showing past transactions on account is not periodic statement under § 8(n)

§ 226.8(q) Periodic statement on closed end credit card account showing amound due must comply with § 8(q)

May 6, 1976

This is in response to your letter of . . . , and our earlier phone conversation, regarding the applicability of Truth in Lending and Regulation Z to the quarterly statements of account sent to credit union members. Specifically, you question whether a credit union must comply with § 226.8(n) of Regulation Z when the credit union sends quarterly account statements to members which reflect information about past transactions on the account. As I indicated in our phone conversation, the disclosure requirements of § 226.8(n) apply only to statements which are in the nature of a notice, or reminder of payment due on a transaction which is mailed periodically to the customer in advance of the due date of the instalment. Thus, the statements which a credit union provides its members reflecting past payments on the account are not periodic statements as contemplated by § 226.8(n). Consequently, there is no need to comply with the disclosure requirements of Regulation Z regarding those statements.

You further inquire of the periodic statement disclosure requirements should a credit card be involved in an other than open end account. If a credit card is used with such an account and the transaction is reflected on a periodic statement or billing sent to the customer indicating the amount due, then the creditor providing such a statement must comply with § 226.8(q) of Regulation Z and the requirements outlined therein.

I trust this is responsive to your inquiry and alleviates any confusion that may have arisen regarding the applicability of Regulation Z to such credit union accounts.

Very truly yours,

Dale R. Granchalek
Attorney
Fair Credit Practices Section

No. 1047

§ 226.6(a)

"Meaningful sequence" provision does not require any specific arithmetical progression for disclosures, but related terms must be presented in way that assists customers in understanding relationship (See also 780)

May 20, 1976

This is in response to your letter of . . . , requesting staff's interpretation of the term "meaningful sequence" as used in § 226.6(a) of Regulation Z.

In the recent case of Allen v. Beneficial of Gary, Inc. (4 CCH CCG ¶ 98,477), the court quoted from staff's Public Information Letter 780, dated April 10, 1974, in considering whether a particular set of disclosures was made in meaningful sequence as required by the Regulation. That staff letter states that "meaningful sequence" requires that those prescribed disclosures which have some arithmetical relationship to each other be presented in a logical order or progression. The Allen decision has been interpreted by some to mean that the various disclosure elements must be arranged in a "summation column," as opposed to a subtractional order, in order to comply with the requirement for a meaningful sequence.

Neither § 226.6(a) nor Public Information Letter 780 sets forth any particular "arithmetical progression" which must be used in making disclosures. In staff's opinion, the Regulation does not require all presentations to be made within the rigid confines of some particular series of additions or subtractions. In fact, we believe it is not really appropriate to speak of a "summation" or "subtractional" method as though these were two separate and mutually exclusive types of disclosures. In order to comply with the requirements of § 226.8, most disclosure statements would necessarily involve both additions and subtractions of various items. For example, a disclosure beginning with the total of payments, which some might characterize as a subtractional method, would probably involve an addition process in disclosing an amount financed which includes other charges or a finance charge composed of more than one component. In contrast, a disclosure beginning from the amount of loan proceeds, which would apparently be considered a summation method, would require a series of subtractions if the transaction involved a prepaid finance charge and/or a required deposit balance. We believe that the invalidity of attempting to categorize disclosure methods in this way may be illustrated by the provisions of § 226.8(c). The series of disclosure items outlined in that section involve a mixture of subtractions and additions which cannot, in our view, be described with some particular arithmetical label.

In staff's view, "meaningful sequence" cannot--and should not--be defined by reference to some rigid concept of arithmetical progression. Since a primary purpose of this requirement and of the Truth in Lending Act as a whole is to adequately inform consumers of the terms and costs of credit, we believe that § 226.6(a) requires that related terms be presented in an order which will assist the customer in understanding their relationship. Given the wide variety in credit transactions, "meaningful sequence" must be determined by reference to the particular set of disclosures under consideration. An arrangement of elements which is suitable for one type of transaction may not necessarily be adequate for another type of transaction. So long as the placement makes clear the relationship among the various disclosure terms, a disclosure statement may still be in compliance with § 226.6(a) even though the terms are placed in a horizontal (see Exhibit E in the Board's earlier Regulation Z pamphlet) rather than a vertical order or in a descending rather than ascending progression.

We trust this is responsive to your inquiry.

Sincerely,

Jerauld C. Kluckman
Assistant Director

No. 1053

§ 226.8(b)

Disclosure of security interest in "all" after-acquired property would not comply with § 226.8(b)(5) where State law imposes limitations on application of interest to such property.

May 28, 1976

This is in response to your letter of . . . , regarding our previous correspondence on disclosure of a security interest in after-acquired property under § 226.8(b)(5) of Regulation Z.

In staff's letter of January 9, we indicated that a creditor need not state the conditions or limitations imposed by State law in the disclosure of a security interest in after-acquired property under § 226.8(b)(5). Specifically, it would not be necessary for a creditor to provide a statement of the effect of § 9-204 of the Uniform Commercial Code on security interests in after-acquired property.

You state that certain retail instalment contracts indicate that the creditor is reserving an interest in all after-acquired property including all attachments, substitutions, and replacements, without any indication of the limitations imposed by § 9-204. You ask whether this would constitute a violation of either § 226.6(c) or § 226.8(b)(5) of the Regulation.

It appears from your letter that these creditors are disclosing a security interest in "all after-acquired property" or "all after-acquired property including all attachments, substitutions, and replacements." If, in fact, the applicable State law only permits acquisition of a security interest in after-acquired property acquired within a certain period of time, then such a statement would be improper under Regulation Z. As our previous letter indicates, a simple disclosure of the fact that after-acquired property may be subject to the security interest would be sufficient to comply with the clear language of § 226.8(b)(5), without an explanation of the various conditions and limitations on such interests which may be imposed by the applicable State law. However, the fact that the creditor need not disclose such limitations and conditions does not mean that the creditor may affirmatively misstate the scope of the security interest, in disregard of those limitations. If, in fact, the creditor discloses an interest in "all after-acquired property," when the interest would actually attach only to property acquired by the borrower within a certain period of time, such a disclosure would be inaccurate and misleading in violation of Regulation Z.

We apologize for the delay in our response and hope that it has not caused you undue inconvenience.

Sincerely,

Jerauld C. Kluckman
Assistant Director

No. 1094

§ 226.7(a)

Adequacy of security interest disclosure for open end credit plan

August 6, 1976

This is in response to your letter of . . . , regarding the disclosure requirement of § 226.7(a)(7) of Regulation Z. Your question is whether the following disclosure is sufficient to describe a security interest which secures an open end line of credit with the bank. The disclosure is as follows:

> "To secure payment of Customer's obligations to Bank under this Agreement [establishing the line of credit], Bank shall upon default acquire a security interest under Article 9 of the Uniform Commercial Code in all property of Customer (other than funds held on deposit) in possession of Bank at the time of default and other property securing other existing and future indebtedness pursuant to any written security agreement between Bank and Customer describing such property."

Your proposal is designed to take advantage of the benefit of security interests the bank has or will have in property of its customer pursuant to other loan transactions. For example, if the bank finances an automobile loan and takes a security interest in the automobile, the bank proposes to use that security interest for the line of credit indebtedness. The question is then whether the above quoted disclosure is sufficient to comply with the requirement in § 226.7(a)(7) that the security interest be described or identified and that the conditions under which the creditor may retain or acquire it be stated.

In the view of staff, it appears that your proposed disclosure both indicates the conditions under which the creditor may retain or acquire any security interest and describes or identifies the type of interest or interests which may be so retained. Thus, in staff's view, it would appear that the disclosure is sufficient to comply with the requirements of § 226.7(a)(7).

I trust this is responsive to your inquiry and is helpful to you in understanding the requirements of Regulation Z. This is an unofficial staff interpretation of Regulation Z.

Very truly yours,

Dale R. Granchalek
Attorney
Fair Credit Practices Section

No. 1130

§ 226.10(d) The term "up to 48 months to pay" is a triggering term (period of repayment) which, when used in an advertisement, requires full advertising disclosures.

November 17, 1976

This is in response to your letter of . . . , in which you inquired as to the advertising disclosure requirements of Regulation Z pertaining to bank loans. Specifically, you asked whether a local bank which is using newspaper media to advertise loans with text reading "up to 48 months to pay" is required by the regulation to make further disclosure as to the annual percentage rate, the amount of payments, and the total amount of the loan.

It is staff's opinion that the term "up to 48 months to pay" is a triggering term which, when used in an advertisement, requires full advertising disclosures under § 226.10(d) of Regulation Z. Specifically, § 226.10(d) requires that any advertisement which aids, promotes, or assists directly or indirectly any loan or other extension of credit which states the "period of repayment" must also state the following items:

1) the cash price or amount of the loan if applicable;

2) the number, amount, and due dates or period of payments scheduled to repay the indebtedness if the credit is extended;

3) the amount of the finance charge expressed as an annual percentage rate with certain exceptions; and

4) except in the case of a loan to purchase a dwelling secured by a first lien on the dwelling, the total of payments in a loan or other extension of credit.

The term "up to 48 months to pay" is use of the period of repayment and triggers the required disclosures listed above. Failure to give full advertising disclosures in connection with use of such a term in the advertisement constitutes a violation of Regulation Z.

I enclose a copy of Regulation Z for your information. This is an unofficial interpretation of Regulation Z. I trust this is responsive to your inquiry.

Sincerely,

Jerauld C. Kluckman
Assistant Director

Enclosure

No. 1142

§ 226.7(b)(1)(x) Credit union auditor's notice, which is used in the biannual verification of its members' accounts and describes the method whereby discrepancies in the members' accounts should be reported may be misleading and confusing and, therefore, conflicts with the Regulation's provisions requiring that a customer be provided with an address to be used in forwarding a billing error notice.

§ 226.6(c) " " " " "

January 7, 1977

This is in response to your letter of . . . , regarding § 226.7(b) of Regulation Z.

In your letter you enclosed an envelope with a message printed on the back of it. You indicate that this envelope is sent to credit union members with their quarterly statements in order to facilitate a biannual verification of its members' accounts as required by the Federal Credit Union Act. The message on the envelope reads as follows:

> Our auditor, . . . is confirming our members' share and loan balances in accordance with Regulations. Please examine the enclosed statement carefully. If it agrees with your records, please disregard this request. If it does not, please report the differences with supporting information directly to the auditor in the enclosed postage free envelope.
>
> THIS IS NOT A REQUEST FOR PAYMENT.

You state that most credit union computers produce a quarterly statement with a section entitled "send inquiries to" and that, generally, the name and address of the credit union appears in this section on the quarterly statement. You question whether the printed message is in conflict with the provisions of Regulation Z requiring that a customer be provided with an address to be used in forwarding a billing error notice.

Section 226.7(b)(1)(x) requires that a creditor of any open end account mail or deliver to the customer for each billing cycle a statement setting forth an address to be used by the creditor for the purpose of receiving billing inquiries. The section further provides that such an address be preceded by the caption "Send Inquiries To:," or other similar language indicating that the address is the proper location to send such inquiries. In light of § 226.7(b)(1)(x) and § 226.6(c), which provides in part that additional information or explanations supplied with any disclosures required under the Regulation cannot be stated so as to mislead or confuse the customer, staff is of the opinion that your message envelope, in being forwarded with the quarterly statement, may prove misleading or confusing to the customers if, in fact, a billing error subject to the resolution procedures outlined in Regulation Z does appear on such a quarterly statement.

Staff believes that such potential confusion could be eliminated by the insertion or addition of a qualifying statement to your notice indicating that the reporting of any inaccuracies pursuant to the auditing process in no way interferes or satisfies the billing error resolution procedures available under Regulation Z.

This is an unofficial staff interpretation of Regulation Z and I trust that it is responsive to your inquiry. I hope the delay in responding has not inconvenienced you.

Sincerely,

Jerauld C. Kluckman
Associate Director

No. 1154

§ 226.8(a) — § 226.801 applies only where combined form is necessary due to mechanical processing problems; in other situations, general rule of § 226.8(a)(1) applies re location of disclosures.

§ 226.801 — " " " " "

February 10, 1977

This is in reply to your letter of . . . , in which you requested several publications from the Federal Reserve Board and raised a question concerning Board Interpretation § 226.801. I understand that the publications you requested have been mailed, interpretation.

You quoted from the language of the second paragraph in § 226.801 and remarked that although many lenders use a form which combines the note, disclosure statement, and security agreement in a single document, you have never seen a form providing the notice required by § 226.801, or one which provides for the customer's signature on the reverse side following the full content of the document. You ask whether § 226.801 has been repealed or modified, or if the forms you refer to are all in violation.

It appears that you may have misunderstood the intent of § 226.801. As explained in prior Public Information Letters 527, 782, 825, and 1016, copies of which are enclosed, this interpretation was written to alleviate a specific problem, and it only applies when the contract, security agreement (if any), and evidence of the transaction are combined into a single document designed for processing by mechanical or electronic equipment. Therefore, the special provisions of this interpretation, including the notice and the signature following the full content of the document, apply only in those circumstances.

If the combined note/disclosure statement/security agreement to which you refer is not of the type described in the first paragraph of § 226.801, the interpretation would not apply. Rather, the general rule of § 226.8(a)(1) is applicable, and it provides that, if disclosures are made on the instrument, the disclosures must be made together on the same side of the page and above or adjacent to the place for the customer's signature. The combined instrument may encompass more than one page and the contractual terms may appear anywhere, but all of the Truth in Lending disclosures must be made on the same side of the page above or adjacent to the place for the customer's signature.

This is an unofficial staff interpretation of Regulation Z, and I trust that it will prove helpful to you.

Sincerely,

D. Edwin Schmelzer
Chief, Fair Credit Practices Section

No. 1170

§ 226.7(a)

Disclosure of use of 360-day year in computing finance charges is generally permissible but saying the factor based on a 360-day year will be applied to the outstanding balance each day is misleading and inaccurate.

March 28, 1977

This is in response to your letter of . . . , in which you requested that staff reconsider the position taken in Public Information Letters 120 and 281 regarding the use of a 365-day year as opposed to a 360-day year when computing finance charges based on a daily period.

You state that your client, a credit union, offers its members an open end credit plan. The method of computing the finance charge for this plan is disclosed as follows:

> "Any loan with a loan type beginning with J is open end credit. The Finance Charge is computed at a periodic rate of .0003333 per cent per day, or 1 per cent per month, annual percentage rate 12 per cent, applied to each amount in the balance column for the number of days that balance was outstanding. The daily factor is computed on a 360 day calendar year."

You state in your letter that this is proper because: (1) the regulation defines a "period" as a day, week, month or other subdivision of a year (which, in your view, would encompass a period of 1/360th of a year) and (2) using an annual percentage rate based on a 1/360th-year period is, in your view, not inaccurate since the periodic rate of .0003333 times the disclosed period of 30 days per month does equal, within 1/4 of one per cent, 1 per cent per month, or an annual percentage rate of 12 per cent.

Staff is of the opinion that the annual percentage rate your client discloses would be properly shown as 12 per cent if, in fact, the "daily" rate of .0003333 per cent is applied to the outstanding balances for 360 periods per year. However, since a day is not 1/360th of a year, staff believes that the disclosure regarding the method of computing the finance charge (i.e., by applying that "daily" periodic rate to each balance for the number of days it is outstanding) may be misleading, since this appears to indicate that in a 31- or 28-day month the "daily" rate will be applied to the outstanding balance on each of those days. If that is the case, then your client's "daily" rate will be applied to the outstanding balance for 365 days. This would result in an annual percentage rate of 12.17 per cent which, if rounded to the nearest 1/4 per cent, is 12.25 per cent and not 12 per cent. (You will note that the standard for accuracy is that the annual percentage rate may be rounded to the nearest 1/4 per cent and not, as you suggest, that it must be accurate to within 1/4 per cent.)

In staff's opinion, your client's disclosure is not made accurate by indicating that the "daily factor" is based on a 360-day calendar year. Evidently, you take that to mean that each month, for computational purposes, has 30 days. Although this may be a plausible interpretation, it would still be subject to contradiction by the preceding sentence which states that the rate is applied to the amount of each balance for the number of days it is outstanding. That sentence appears to say that the "daily factor" (.0003333 per cent) is computed by dividing the 12 per cent annual percentage rate by 360. It does not appear to indicate that there are, consequently, only 360 days in the year for which finance charges will be assessed by applying that rate to the outstanding balance.

Since staff believes the opinions expressed herein are consistent with those expressed in Public Information Letters 120 and 281, reconsideration of those letters does not appear to be appropriate.

Since this letter does not contain opinions upon which creditors may wish to rely, this is an unofficial staff interpretation of Regulation Z. I trust this is responsive to your inquiry.

Sincerely,

Jerauld C. Kluckman
Associate Director

No. 1287

§ 226.10(d)

"Up to 48 months" and "we now offer longer term loan packages, up to 48 months" state period of repayment within meaning of § 226.10(d)(2) and trigger requirements of that section; but advertisement need not set forth disclosures for loans with terms of less than 48 months.

March 22, 1978

This is in response to your letter of . . . , requesting an official staff interpretation of § 226.10(d)(2) of Regulation Z. Specifically, you ask that the position taken in our Public Information Letter 1130 (November 17, 1976) be reevaluated.

In Letter 1130 the staff concluded that use of the phrase "up to 48 months to pay" in an advertisement for an extension of credit, other than open end, constitutes a statement of the "period of repayment" within the meaning of § 226.10(d)(2) and necessitates disclosure in the advertisement of all of the other credit terms specified in §§ 226.10(d)(2)(i) through (v). Letter 1130 reflects the staff's longstanding position that a statement of the maximum term of a loan in an advertisement requires the creditor also to set forth all of the other information prescribed in § 226.10(d)(2). (See, e.g., Public Information Letters 391, 519, 844, and 1022, copies of which are enclosed.)

You contend that the requirements of § 226.10(d)(2) should not be triggered by the phrases "up to 48 months" and "we now offer longer term loan packages, up to 48 months" (both of which your bank wishes to use in advertising new car loans), because, in your view, these phrases do not state the actual period of repayment for a specific credit transaction.

In the staff's opinion, the purpose of the advertising provisions contained in § 226.10(d)(2) of Regulation Z is to insure that consumers will not be misled by being told some, but not all, of the important terms of certain advertised credit transactions. While the phrases which your bank proposes to use might imply that loans for periods of less than 48 months are available, the phrases clearly indicate that a consumer can obtain a new car loan with a "period of repayment" (as that term is used in § 226.10(d)(2)) of 48 months. In adopting § 226.10(d)(2), the Board of Governors implemented § 144(d) of the Truth in Lending Act which expresses the intent of Congress that credit advertisements not set forth the period of repayment for a credit transaction without also disclosing the other important terms of the transaction. Consequently, the staff believes that if your bank advertises loans of "up to 48 months" or that "we now offer longer term loan packages, up to 48 months," such advertisements must also set forth all of the credit terms required by §§ 226.10(d)(2)(i) through (v).

You express concern that under the requirements discussed above and in Letter 1130, if your bank advertises loans of "up to 48 months," it will have to give the information prescribed in § 226.10(d)(2) not only for 48-month loans but also for loans with shorter repayment periods. The staff believes, however, that the information required by § 226.10(d)(2) would have to be set forth only for a 48-month loan if no other specific repayment period were mentioned in the advertisement.

Although you requested an official staff interpretation of Regulation Z, the staff feels that the issues you raise do not address a technical ambiguity in the regulation and that, for that reason, an official staff interpretation would be inappropriate. Therefore, this is an unofficial staff interpretation of Regulation Z, limited in its applicability to the facts and issues discussed above. If you have additional questions you may wish to contact the Federal Reserve Bank of Atlanta or this office.

Sincerely,

Dolores S. Smith
Attorney

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No. 1288

§ 226.7(a)

Billing error notices should not be altered even in light of "plain English" laws.

March 31, 1978

This is in response to your letter of . . . , requesting an official Board interpretation of § 226.7(a)(9) of Regulation Z.

As you note, § 226.7(a)(9) requires that a "statement [of billing error rights, procedures and obligations] containing substantially the following text, as applicable, written clearly and conspicuously, shall accompany the statement required by paragraph (2) of this section, ..." You state that several States, including New York, now require that credit agreements be written in simplified language. In light of this requirement, you ask if the billing error notice referred to above may be simplified and reorganized so long as the meaning remains substantially the same.

The staff believes that, except for deletion of inapplicable, and therefore potentially misleading, material or changes designed to personalize the wording of the billing error notice pursuant to footnote 7, the notice should not be altered. The notice, as currently written, appears to comply with the spirit of the new "plain English" laws because it is phrased in common and clear non-technical language. In addition, its function is to give consumers as full an understanding of their rights as possible, the same function as the "plain English" requirement.

You have requested an official Board interpretation. However, the question you present does not involve a general controversial issue regarding a substantial ambiguity in the regulation. Consequently, staff believes the issuance of a Board interpretation in response to your inquiry would be inappropriate. Accordingly, this is an unofficial staff interpretation, limited in its application to the facts and issues addressed herein.

If you have further questions, please contact the Federal Reserve Bank of New York or this office. I trust you find this letter of assistance.

Sincerely,

Glenn E. Loney
Section Chief

APPENDIX 8

SELECTED FRB LETTERS

Number	Topic
EC-0005	Requests for "monitoring information"; Collection of "monitoring information"
EC-0006	Credit evaluations using both credit scoring and judgmental bases
EC-0013	Approval of NCUA model loan application
EC-0014	Treatment of credit card "authorized users" as joint applicants
No. 2	Signature of non-applicant spouse on documents
No. 5	Signature of co-owner on jointly owned property
No. 8	"Application" refers to actual practices
No. 9	Discrimination on the basis of alienage; Consideration of "national origin"
No. 10	Information required by FHA regarding guaranteed loans

EC-0005

Section

202.13

Mortgage lender should request data if applicant seeks both temporary financing to construct dwelling and permanent financing, but not if application is limited to construction financing; where separate form is used, lender should include questions about marital status and age.

April 8, 1977

This is in response to your February 17 letter regarding § 202.13 of Regulation B. I apologize for the delay in answering. In accordance with your request, this is an official staff interpretation of the regulation, issued pursuant to § 202.1(d).

Your first question is whether a mortgage lender must request the information required by § 202.13 for monitoring purposes in connection with consumer credit applications relating to the construction of residential real property as well as in connection with applications relating to the purchase of such property. You point out that § 202.13(a) uses only the word "purchase," while the model residential real estate mortgage loan application in Appendix B uses the phrase "purchase or construction."

In the opinion of the Board's staff, a creditor need not collect information pursuant to § 202.13 when an applicant applies for consumer credit relating solely to the temporary financing of the construction of a residential dwelling. If, however, a consumer credit applicant applies for both a temporary loan to finance the construction of a residential dwelling and a permanent mortgage loan to take effect when the construction is successfully completed, then the lender has received an application covered by § 202.13 and must comply with the requirements of that section.

In any event, if a mortgage lender uses an application form that contains a monitoring information section pursuant to § 202.13 and an applicant inadvertently supplies the information in a situation not covered by § 202.13, the creditor nevertheless may act on and retain the application without violating Regulation B. The creditor would be protected by § 202.12(a)(3) since the information would not have been obtained in response to a specific request of the creditor.

Your second question is whether a creditor should include questions about marital status and age on a separate form that is used, pursuant to § 202.13(b), for the purpose of collecting monitoring information. You note that the section of the model mortgage loan application relating to monitoring does not include questions about marital status or age; those questions appear on the front of the model form. You indicate, however, that you think that any creditor using a separate form should include questions on that form concerning an applicant's age and marital status.

If a transaction is subject to § 202.13, a creditor must request information about an applicant's age and marital status either on an application form or ~~on~~ a separate monitoring form. If the information is requested on an appliction form for appropriate consideration under § 202.6, then the creditor need not request the information again for monitoring purposes and need not inform the applicant under § 202.13(c) that age and marital status information is being voluntarily requested for government monitoring purposes. If, however, age and marital status information is not sought for credit-related purposes on an application form, then the creditor must ask for that information either in a monitoring section on the application or on a separate monitoring form; and the creditor must provide the disclosures required by § 202.13(c).

I trust that this official staff interpretation answers your questions. If we can be of further assistance, please let us know.

Sincerely,

Nathaniel E. Butler
Associate Director

EC-0006

Section

202.2(p)

System for evaluating creditworthiness may include both credit scoring and non-scoring components, provided each component complies with limitations imposed by regulation. Aspects of transaction need not be scored.

April 13, 1977

Thank you for your letter of March 14, 1977 pertaining to § 202.2(p) of Regulation B. You describe a situation in which a creditor requires that an applicant receive a passing score in a credit scoring system and then, in addition, pass certain judgmental tests in order to receive credit. You inquire whether a credit scoring system which considers the applicant's age may be used in conjunction with other judgmental tests when analyzing an applicant's creditworthiness.

Section 202.2(p)(1) of Regulation B provides that an empirically derived credit system is a credit scoring system which evaluates creditworthiness primarily by scoring the attributes of the applicant. Other aspects of the transaction may, but need not, also be scored. The scoring portion of the demonstrably and statistically sound, empirically derived credit system may be combined with additional information about the applicant which is pertinent to creditworthiness.

Section 202.2(p), therefore, contemplates that a demonstrably and statistically sound, empirically derived credit system is composed of a scoring component and that it may also have a non-scoring component. The scoring component of the system is required to pass certain statistical standards, which are prescribed in detail in § 202.2(p)(2) of Regulation B. If it passes those tests, then age may be used in the scoring system. If age is used as an attribute which is scored, elderly applicants may not receive a negative factor or value for their age.

The non-scoring component is optional. If the system does have a non-scoring component, that component must comply with the requirements imposed upon judgmental systems of evaluating applicants. In particular, the non-scoring component of the demonstrably and statistically sound, empirically derived credit system may not consider the applicant's age directly. The non-scoring component may consider "pertinent elements of creditworthiness" which may incidentally be correlated with or dependent upon age.

The non-scoring component of a demonstrably and statistically sound, empirically derived credit system may consist of one or more additional credit analysis factors. As we understand it, these factors might include obtaining a credit report, undertaking a cash flow analysis, consideration of events such as bankruptcy which occur too infrequently for development as a scored attribute but which are highly pertinent to creditworthiness, appraisal of collateral, and exercise of discretion by a credit officer. The components may interact in any way that the creditor finds useful in evaluating creditworthiness, so long as the scoring component conforms to the requirements of §202.2(p)(2) and the non-scoring component conforms to the rules for judgmental systems.

The entire system including the scoring and non-scoring components is, of course, subject to the general rule of § 202.4, prohibiting discrimination, and to the full impact of the effects test.

We hope that the foregoing responds fully to your inquiry. This is an official staff interpretation of Regulation B.

Sincerely,

Nathaniel E. Butler
Associate Director

EC-0017 (Effective July 30, 1979)

Section

202.5(e)

NCUA model loan application as revised 4/79 complies with Regulation B.

June 8, 1979

You ask us in your letter of . . ., to approve the National Credit Union Administration's model loan application, form NCUA 6001 (4/79), for compliance with Regulation B.

We have examined the model application (a copy of which is enclosed), and, in our opinion, it fully complies with §§ 202.5(c) and (d) of Regulation B. We therefore believe that a credit union that properly uses the application also complies with those provisions of the regulation. We would point out that any credit union that accepts a credit application relating to the purchase of residential real property, where the credit is to be secured by the property, must solicit from the applicant or applicants information for monitoring purposes as provided in § 202.13.

As you have requested, this is an official staff interpretation of Regulation B. It will become effective 30 days after publication in the Federal Register unless a request for public comment, made in accordance with the Board's procedures, is received and granted. We will notify you if the effective date of the interpretation is suspended.

Very truly yours,

Nathaniel E. Butler
Associate Director

Enclosure

APPLICATION FOR LOAN

(unsecured/secured closed end)

Information regarding: ☐ Applicant ☐ Additional party

Date ____

Name ____ Account # ____

I/We hereby apply for a loan as follows: (** to be completed by applicant)

Amount of money requested	$ ____ **
Old loan balance (if any)	$ ____
Accrued finance charge (interest due)	$ ____
Other charges	$ ____
Total new loan	$ ____
To be repaid in ** ____ payments of	$ ____

Including/plus interest starting on ____

Purpose of loan** ____

☐ Individual Credit: (Do NOT complete marital status for INDIVIDUAL credit in non-community property state.)

☐ Applicant's signature only

☐ Endorser, guarantor or surety (Co-signer) (Name ____)

(Have this person complete a separate loan application.)

☐ Joint Credit - Joint Applicant or Co-maker (person who will be equally liable for repayment)

(Name ____)

(Have this person complete a separate loan application.)

Relationship to applicant, if any ____

☐ Secured Credit - Collateral

Shares in Account Nos. ____ $ ____

New/Used Auto - Make ____ Year ____ Cost/Value $ ____

Other: ____

Owners' Names ____

MARITAL STATUS: Complete marital status if this loan is for.

a. Joint or secured credit, or

b. You reside in or rely on property located in a Community Property State. (AZ, CA, ID, LA, NM, NV, TX, WA)

☐ Unmarried ☐ Married ☐ Separated

Full Name ____ Birth Date ____ Social Security No. ____

Drivers Lic. No. ____ Street Address ____

City ____ Years there ____

Home Phone ____ Business Phone ____ State ____ Zip Code ____

Years there ____ Position or Title ____ Present Employer ____

Employer's Address ____ Supervisor ____

City ____ State ____ Zip Code ____

Dependents (exclude self) ____ Ages ____

Name of nearest relative not living with you ____ Relationship ____

Address ____

*Alimony, child support or separate maintenance income need not be revealed if you do not wish to have it considered as a basis for repaying this loan.

Salary (☐ Gross ☐ Net) $ ____ Per ____

Other Income ____ Per ____ Source ____

Is any income listed likely to be reduced before this loan is paid off? ☐ No ☐ Yes

If yes, explain ____

Share Draft or Checking Account No. ____ Where ____

Share or Savings Account No. ____ Where ____

NCUA 6001 (4-77)

If present residence less than 2 years, complete next lines

Previous Street Address ________________ Years there ______

City ________________ State ______ Zip Code ______

If employed by above less than 3 years, complete next lines

Previous Employer ________________ Years there ______

Previous Employer's Address ________________

OUTSTANDING DEBTS (List Everything)

Creditor (address and account #)	DATE LOAN	ORIG. DEBT	PRESENT BALANCE	MONTHLY PAYMENT	Past Due Yes/No
Mortgage					
Auto loan					
Credit Union					
Credit Card					
Credit Card					
Alimony, etc.					
Other					
Other					
Attach another sheet if necessary					
TOTALS					

Are there any other persons obligated on any of the above loans? ☐ No ☐ Yes

(Which ones and who? ________________)

Are you a co-maker, co-signer or guarantor on any loan? ☐ Yes ☐ No

For whom? ________________ To whom? ________________

Have you been declared bankrupt in the last 14 years? ☐ No ☐ Yes

Everything that I have stated in this application is correct to the best of my knowledge. You are authorized to check my credit and employment history and to answer questions about your credit experience with me.

Signature of Member ________________ Date ________

CREDIT COMMITTEE/LOAN OFFICER ACTION

Loan officer:

☐ I approve the loan as submitted.

☐ Loan referred to CC Reason ________________

LO signature ________________ Date ________

Credit Committee: Date ________

☐ We approve the loan as submitted

☐ We reject the loan as submitted

☐ The following counter offer will be made to the applicant and if accepted, we approve the loan. Describe ________________

____

Specific reason(s) for rejection ________________

Outside information considered ☐ No ☐ Yes (describe ________________)

Signed ________________ Date ________

Signed ________________ Date ________

Signed ________________ Date ________

☐ ECOA notice and Reason for Rejection sent or delivered on ________________

Signed

EC-0014 (Effective August 30, 1979)

§ 202.7(d)(1)

Credit card issuer may treat "authorized users" as joint applicants, therefore requiring them to assume contractual liability for the account.

July 11, 1979

You ask in your . . . letter for an official interpretation of Regulation B. Your client, a bank, proposes to require all "authorized users" of credit cards that it issues to sign the credit agreement, thereby assuming contractual liability for the account. You ask whether Regulation B prohibits the proposed practice.

As you point out, the signature provisions in § 202.7(d) do not mention "authorized users." In the absence of any specific mention of authorized users, the general signature rule of § 202.7(d)(1) applies, and the issue becomes: may a creditor require that all authorized users become co-obligors and treat them as joint applicants?

The staff continues to adhere to the position taken in previous informal letters that a creditor may condition its acceptance of authorized users upon their becoming co-obligors and, thus, joint applicants too. Since the creditor is not seeking the authorized user's participation in the credit plan, the creditor may restrict that participation to a person who agrees to become a co-obligor and applicant by signing the relevent credit documents. Such a policy, if applied in a non-discriminatory fashion, would not violate Regulation B.

Obviously, a creditor may permit authorized users without requiring that they also become joint applicants and assume contractual liability for the account. Indeed, a creditor could accept authorized users but not allow joint applicants, or could offer only individual accounts without authorized users. Please also recall that § 202.7(a) provides that "a creditor shall not refuse to grant an individual account to a creditworthy applicant . . . ." Therefore, a creditworthy applicant seeking a single credit card for his or her sole use may not be required to provide additional signatures.

No. 2 (redesignated 3/11/77)

Section

202.7(d)
(202.7 of original Reg.B)

Whether creditor may require signature of non-applicant spouse on an instrument.

NOTE: This letter was originally issued as Public Information letter #67 on April 21, 1976.

We are responding to your letter of March 12, 1976, in which you ask whether creditors may require the signature of the applicant's spouse on an integrated truth in lending disclosure statement, note and security agreement without violating the provisions of section 202.7 of Regulation B.

It is our opinion that creditors may not as a matter of course require the signature of a non-applicant spouse on a note. There are certain circumstances in which the non-applicant spouse may be required to sign the note as well as other instruments, but such signature may not be required under a blanket rule. For example, the non-applicant spouse may be required to sign if that spouse's creditworthiness is necessary to support the amount and kind of credit sought. If the non-applicant spouse has income which is necessary to repay the debt, that spouse's signature could be required on the note. Of course, this determination would have to be made on a case by case basis.

Another example of a situation in which a non-applicant spouse can be required to sign the note occurs in certain jurisdictions where it is necessary for both spouses to sign not only security instruments, but also the instrument evidencing the indebtedness in order to create a valid and enforceable lien. In those states, the non-applicant spouse can be required to execute the note as well as the security instrument.

Although the non-applicant's signature may not be required on the note, it may be required on other instruments. If the creditor reasonably believes it is necessary to have the non-applicant spouse execute certain documents to create valid liens, pass clear title, waive inchoate rights to property, or assign earnings, the creditor may require the signature of the non-applicant spouse on the documents appropriate to accomplishing these ends. For example, a creditworthy married female seeking individual credit who offers a car which is owned jointly with her husband as security could be required to sign the integrated truth in lending disclosure statement, security agreement and note. The husband could not be required to sign the integrated instrument, but he could be required to sign a separate security agreement and other documents necessary to create an enforceable lien.

It should be pointed out, however, that a non-applicant spouse may wish to execute the debt instrument even though that spouse's signature could not and would not be required to support the credit being sought. For example, the spouse may want to be contractually liable in order to reap the benefits of a credit history that would reflect the note's having been paid according to its tenor. In situations where the offer to become liable on the debt is truly voluntary, creditors should permit those spouses to sign the note.

The views expressed above as well as those in the enclosed Public Information letters are those of the staff and are in no way binding upon the Board.

We hope this information will be of assistance to you.

Sincerely,

Nathaniel E. Butler
Chief, ECOA Section

No. 5

Section

202.7(d)
(202.7 of original Reg. B)

Requests for signature of co-owners of jointly owned property; exclusion of jointly owned property from consideration in evaluating creditworthiness.

March 1, 1977

We are writing in response to your request for an interpretation of section 202.7 of Regulation B. The issue raised in your letter, the restrictions under the Equal Credit Opportunity Act and Regulation B relating to requests for signatures, was addressed by the Board during the recently completed rule-making proceeding. Since the regulatory provisions relating to requests for signatures have been expanded and, we believe, clarified, a Board interpretation on the subject does not appear to be necessary. This letter will describe the application of the general regulatory provisions to the specific situations mentioned in your letter.

You asked whether a creditor may establish a blanket policy of either (1) requiring all co-owners of property that has been pledged to secure an obligation or relied upon in establishing creditworthiness to execute the note evidencing the obligation or (2) excluding jointly owned assets from consideration in evaluating applications. As explained more fully below, the staff believes that such blanket policies contravene the general rule set forth in both the existing and amended Regulation B.

Section 202.7 of the regulation is based upon subsections (a) and (b) of section 705 of the Equal Credit Opportunity Act which provide:

> (a) a request for the signature of both parties to a marriage for the purpose of creating a valid lien, passing clear title, waiving inchoate rights to property, or assigning earnings, shall not constitute discrimination under this title: Provided, however, that this provision shall not be construed to permit a creditor to take sex or marital status into account in connection with the evaluation of creditworthiness of any applicant.

> (b) Consideration or application of State property laws directly or indirectly affecting creditworthiness shall not constitute discrimination for purposes of this title.

The stated purpose of the Equal Credit Opportunity Act is to "make credit equally available to all creditworthy customers without regard to sex or marital status." With this purpose in mind, the Board has interpreted sections 705(a) and (b) to mean that a creditor may require the signature of a spouse only if the applicant fails to qualify for the credit without the second signature.

In applications for individual credit, the statute permits creditors to obtain the signature of a spouse in two situations. It may be obtained either "for the purpose of creating a valid lien, passing clear title, waiving inchoate rights to property or assigning earnings," or because the applicant does not satisfy the creditor's standards of creditworthiness.

Accordingly, creditors may request whatever signatures are necessary to realize upon the applicant's pledged or unpledged interest in jointly held property. For example, an applicant's spouse may be asked to sign an instrument necessary under State law to create a valid lien, pass clear title, waive inchoate rights to property or assign earnings.

In evaluating the applicant's interest in the property to be pledged or used to establish creditworthiness in an unsecured transaction, creditors are free to consider the form of ownership, the property's susceptibility to attachment, execution, severance, partition, the cost of such action and other factors that may diminish the value of the applicant's interest. After having considered the applicant's interest in the property and having concluded that the individual applicant does not qualify for the amount and terms of credit sought, the creditor may give the applicant the option of providing additional support for the extension of credit which may include, but may not be limited to, the personal liability of the co-owners of the property. Requesting the signature of all co-owners of property or disregarding jointly held property without regard to its bearing on the creditworthiness of the individual applicant, however, is inconsistent with the stated purpose of the Act and violates Regulation B.

We hope this response will be helpful. If you have further questions, please do not hesitate to contact us.

Sincerely,

Griffith L. Garwood
Assistant Secretary to the Board

No. 8

Section

202.2(f)

Application ". . . procedures established by a creditor . . ." refer to actual practices, not stated policies, governing each phase of the application process. (Examples in letter).

April 20, 1978

This responds to your . . . letter requesting a staff interpretation of the definition of application (particularly the phrase "made in accordance with procedures established by a creditor . . . ") in § 202.2(f) of Regulation B. Your inquiry concerns credit shopping and prescreening in residential mortgage lending and asks, in essence, when communications between prospective home buyers or real estate brokers and lenders cease to be shopping discussions and become applications made in accordance with a lender's procedures.

The Equal Credit Opportunity Act and Regulation B prohibit discrimination against credit applicants on nine specific bases. Unless a lender's policies or procedures discriminate against an applicant on a prohibited basis or have that effect, the lender may adopt any policies or procedures that it wishes (consistent with any other applicable laws). For that reason § 202.2(f) defines an application as a request "made in accordance with procedures established by a creditor for the type of credit requested."

The focus, however, is on a lender's actual practices, not its stated policies, governing each phase of the application process. For example, even though a real estate lender's stated policy is to require all applications to be in writing, if the lender makes a credit decision based on an oral request, then an application has been "made in accordance with procedures established by [that] creditor . . . ." The question of whether a credit decision has been made is one of fact and turns, in the staff's opinion, on whether the lender has received sufficient information about the applicant or the collateral on which to base a credit decision (again, considering its actual practices) and whether the lender takes any action to reject the request or to discourage its further pursuit.

The following examples illustrate the staff's views on when an application has been received for Regulation B purposes in the context of residential real estate financing. Each example assumes that the lender has a stated policy of considering applications only when they are in writing.

Example A: Shopping Inquiry

A woman telephones or meets with a loan officer and states that she is purchasing a home in the area and needs a loan. She asks about the lender's loan terms. The loan officer quotes the lender's current finance charge, maximum loan-to-value ratio, maximum maturity, and maximum loan amount. Since the finance charge may vary with the amount of the downpayment or mortgage insurance may be required, the loan officer asks the purchase price of the house and the amount of the contemplated downpayment in order to provide the correct loan term information. The woman supplies the requested information, writes down the loan terms, and concludes the conversation. Has an "application" come into being? No. Although the lender has received some information regarding the woman (the amount of the downpayment that she has available) and the property (the purchase price), it has not made any decision based upon that information.

Example B: Application is Made

Assume the same facts as in example A, except the woman, after learning the loan terms, asks for a 95% loan or states her income and asks whether she qualifies for a loan from the lender. The loan officer, for whatever reason, says no or indicates that there is little point in the woman's applying for a loan. Has an "application" for credit been made? Yes. The loan officer's willingness to reject or discourage the woman's loan request indicates that the request was made in accordance with the application process used by the lender.

Note that, although an application has been received, the lender may not have taken adverse action as defined in § 202.2(c) of Regulation B if applicable law prohibits the lender from making the requested loan or the lender does not extend residential mortgage credit. Otherwise, adverse action has been taken, and the notification and record retention provisions of the regulation apply. If the application is conveyed via telephone and adverse action is taken, then the lender must request the applicant's name and address. If the applicant refuses to provide that information, then the lender, of course, has no further notification obligation.

Example C: No Application Made

Assume the same facts as in example B, except the loan officer, pursuant to the lender's uniform policy, tells the potential applicant (and all potential applicants, without exception) that applications can be considered only if they are in writing. The loan officer gives the potential applicant an application form (or, in a telephone conversation, perhaps offers to mail an application) and invites her to apply. The loan officer may provide general information about the lender's loan policies, but does not evaluate any information given voluntarily by the potential applicant. Has an application been made?

No, because the loan request was not made in "accordance with procedures established by the creditor for the type of credit requested." The lender insists uniformly on written applications before making any judgments. No evaluation has been made at this point, and the lender's procedure for taking a "request for an extension of credit" has been fully disclosed to the potential applicant. If the loan officer had made even a preliminary judgment and communicated it to the potential applicant (as in example B), then the request would have to be treated as an application since, by that action, the lender would be using an application process that involves an evaluation of oral requests for credit.

Example D: Application Is Made

A woman telephones a financial institution and asks about obtaining a loan. The person answering the phone asks about the woman's income and the loan amount sought. The lender's employee determines that the woman's income is insufficient to handle the debt and tells the inquirer that submitting a written application would be a waste of time. Has an "application" been submitted? Yes. The employee's willingness to make a credit decision based on the information provided indicates that the request was made in accordance with the application process used by this particular lender.

Example E: No Application Made

A woman visits a financial institution and asks about obtaining a loan. The interviewing loan officer does not ask the woman about her income, but she volunteers the information anyway. The loan officer, instead of calculating the loan payment-to-income ratio, provides the woman with a simple explanation of the lender's policy on housing expense-to-income and debt-to-income ratios and invites the woman to submit an application if she wishes. No "application" has been submitted up to this point. Although a request for credit has been made, the application process used by the lender requires applications to be in writing. This fact has been communicated to the potential applicant, who has been invited to submit an application in the manner required of all applicants.

Example F: Application is Made

A real estate broker telephones a loan officer at a financial institution and asks if the lender will make a loan to a couple to finance the purchase of a particular piece of property. The broker outlines the couple's financial situation and the terms of the sale's contract. The lender has maintained a relationship with the broker for a number of years and regularly gives a preliminary indication as to whether it will make loans to the broker's clients. Has an "application" been made? Yes, the couple's request for credit was communicated to the lender by the broker. The fact that the lender was willing to evaluate the the information provided and made a preliminary credit decision at that point is evidence that the request is an application for purposes of Regulation B.

As the examples above illustrate, the "procedures established by a creditor for the type of credit requested" are those procedures that are, in fact, employed. Lenders may not avoid their responsibilities under the Equal Credit Opportunity Act and Regulation B by invoking formal standards not consistently applied to all requests for credit.

I trust that this response clarifies when an application exists for purposes of Regulation B. If I can be of further assistance, please let me know.

Very truly yours,

Nathaniel E. Butler
Associate Director

No. 9

Section

202.2(z)

Discrimination on the basis of alienage is not per se a violation of Regulation B.

June 5, 1978

This is in response to your letter of . . . , requesting an unofficial staff interpretation of the term "national origin" as used in § 202.2(z) of Regulation B. Specifically, you ask whether a denial of credit based on the fact that the applicant is not a United States citizen is discrimination on the basis of national origin under the regulation.

The term "national origin" as used in § 202.2(z) refers to the country in which a person was born or from which a person's forebears came. The staff believes that the prohibition in the regulation against discrimination based on national origin does not extend to alienage per se, and, therefore, that a denial of credit based on the fact that the applicant is not a United States citizen is not discrimination based on national origin under Regulation B.

This does not mean, however, that non-citizens have no protection under the regulation. Section 202.4 forbids discrimination against any credit applicant on any prohibited basis, including national origin. Citizenship is not a precondition to the operation of this section; any person who applies for credit is an "applicant" as defined in § 202.2(e). Thus, although alienage itself may be considered, no applicant, whether or not a citizen of the United States, may be discriminated against on the basis of a particular national origin. Furthermore, as is pointed out in footnote 7 to § 202.6(a), any policy of a creditor that has the "effect" of discriminating against applicants on a prohibited basis is also forbidden under the regulation.

These rules are not designed to inhibit creditors from making a good faith determination as to the actual creditworthiness of any individual applicant. Thus, under § 202.6(b)(7):

> "A creditor may consider whether an applicant is a permanent resident of the United States, the applicant's immigration status, and such additional information as may be necessary to ascertain its rights and remedies regarding repayment."

Finally, creditors should be aware that a blanket policy against lending to non-citizens, while possibly not a violation of Regulation B, may be prohibited by other State or Federal laws, such as 42 U.S.C. § 1981.

This is an unofficial staff interpretation of Regulation B. If you have any further questions regarding this matter, please do not hesitate to contact me.

Respectfully,

Robert C. Plows
Section Chief

No. 10

Sections	
202.5(b)(2)	Information regarding applicant's sex, marital status, race or national origin, and age required by FHA in connection with guaranteed mortgage loans may be obtained by creditor pursuant to § 202.5(b)(2) even though information required does not conform to § 202.13 and applicant may not refuse to supply the information.
202.13	" " " "

June 14, 1978

This is in response to your letter of . . . , in which you request an official staff interpretation of Regulation B regarding information which a creditor may request of a loan applicant in connection with FHA guaranteed mortgage loans.

You state that in order for FHA to accept a loan application, a creditor must supply certain information to FHA regarding the applicant's sex, marital status, race or national origin, and age. This information must be supplied whether or not an applicant voluntarily provides the monitoring information specified in § 202.13 of Regulation B. Furthermore, the categories contained on the FHA application for providing this information do not conform to the categories for similar information prescribed by § 202.13. In light of these seemingly contradictory requirements imposed by FHA and Regulation B, you ask whether a creditor may comply with the FHA requirements so that an applicant may obtain an FHA insured loan and yet avoid violating § 202.13 of Regulation B.

It has been and continues to be the staff's opinion that the monitoring information required by FHA falls within the ambit of § 202.5(b)(2) of Regulation B. That section provides that, notwithstanding Regulation B's prohibitions on a creditor's requesting specified information, "a creditor may obtain such information as may be required by a regulation, order, or agreement issued by . . . an enforcement agency . . . to monitor or enforce compliance with the Act, this Part, or other Federal or State statute or regulation." It is the staff's judgment that the information required in connection with FHA loan applications constitutes the type of information contemplated by the Board in adopting

§ 202.5(b)(2). Consequently, a creditor may supply the information required by FHA without violating Regulation B. (This matter has been previously discussed by the staff in a letter to another creditor, and a copy of that letter is enclosed for your convenient reference.)

Although you requested an official staff interpretation of Regulation B, the staff does not believe that such a response would be appropriate inasmuch as your question is readily answered by reference to the regulation itself. Consequently, this is an unofficial staff interpretation of Regulation B, limited in its applicability to the facts and issues discussed above. If you have additional questions, you may wish to contact either Mr. John Yorke, Senior Examiner, Federal Reserve Bank of Kansas City, Kansas City, Missouri 64198, or this office.

Sincerely,

Glenn E. Loney
Section Chief

APPENDIX 9

FEDERAL RESERVE

press release

For immediate release April 19, 1979

The Federal Reserve Board has amended its Regulation B (Equal Credit Opportunity) to clarify the definition of creditor, and is seeking comment on how the anti-discrimination rules of Regulation B should be applied to certain practices of creditors using credit scoring systems.

The amendment the Board adopted makes it clear that the definition of creditor includes not only those who grant credit but also those who regularly refer customers to creditors. Automobile dealerships, home improvement contractors and real estate brokers who regularly steer customers to creditors are examples of those the amendment to Regulation B places under the definition of creditor. The Board's action bringing arrangers of credit within the scope of Regulation B was substantially as proposed in October 1978. The Board did not take action on other proposals made at that time concerning certain business credit exemptions in Regulation B.

At the same time, the Board requested comment, through June 20, 1979, on how the specific rules of Regulation B should apply to four practices of creditors using credit scoring systems. Credit scoring is the use of financial and other information about an applicant, giving numerical weight to answers to questions in order to build up a "score" that can be used to help predict the likelihood that the applicant will repay the credit.

The Board requested comment on how the specific anti-discriminatory rules of Regulation B should be used to avoid discriminatory results when creditors using a credit scoring system follow these practices:

1. Assigning a score to the number of jobs the applicant has, or the number of sources of income the applicant has.
2. Not assigning a score to the amount of the applicant's income from part-time employment, pension or alimony.
3. Giving reasons for adverse action on a credit application that are judgmental rather than arising from the creditor's scoring system.

4. Selecting reasons for adverse action from among the 20 reasons in a model statement included in Regulation B, even though the creditor uses a credit scoring system with attributes not reflected in the model statement.

Regulation B sets out two types of anti-discrimination rules to be followed by all who regularly extend credit. One type of rule is general, or basic: that there should be no discrimination on the basis of sex, marital status, age, race, etc. The other type of rule is specific, including such rules as that a creditor must not "discount", i.e., give less than full weight to, an applicant's income from part-time employment, and that a creditor must give consideration to income from pensions and alimony, under circumstances specified in the regulation. It is the application of these and other specific anti-discrimination rules in Regulation B to the credit scoring practices noted above on which the Board requests comment.

In requesting comment, the Board said:

> Resolving (the four enumerated issues) could entail a variety of regulatory action, including amending Regulation B and issuing official interpretations. Before considering any extensive changes, the Board wishes to encourage a thorough public discussion that will address both the impact of possible changes and the need for any change at all. The options described for each issue are not mutually exclusive and do not constitute the only possible responses. The Board also solicits comment on the general subject of applying Regulation B's specific rules to credit scoring systems.

The Board's notice inviting comment on these proposals, which is attached, explores the issues involved in greater detail, suggests optional solutions and invites the submission of other suggested solutions for the Board's consideration.

There is also attached the Board's notice with respect to the amendment of Regulation B's definition of creditor.

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Proposed Rulemaking

FEDERAL RESERVE SYSTEM

[12 CFR Part 202]

[Reg. B; Docket No. R-203]

EQUAL CREDIT OPPORTUNITY

Application to Credit Scoring

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rulemaking.

SUMMARY: The Board solicits comment on how the specific rules of Regulation B should apply to the following credit scoring system practices: (1) scoring number of jobs or number of sources of income; (2) not scoring the amount of an applicant's income from part-time employment, pension, or alimony; (3) selecting the reasons for adverse action judgmentally; and (4) using reasons for adverse action from the model statement when they do not correspond to the characteristics scored.

DATE: Comments must be received on or before June 20, 1979.

ADDRESS: Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551. All comments should refer to docket number R-203.

FOR FURTHER INFORMATION CONTACT: Dolores S. Smith, Section Chief, Division of Consumer Affairs, Board of Governors of the Federal Reserve System, Washington, D.C. 20551 (202-452-2412).

SUPPLEMENTARY INFORMATION: The Equal Credit Opportunity Act (ECOA) and its implementing Regulation B differentiate between "demonstrably and statistically sound, empirically derived credit systems" and "judgmental systems" of credit analysis. Credit scoring systems that meet specified tests of statistical validity qualify as demonstrably and statistically sound, empirically derived credit systems. All other types of credit analysis constitute judgmental systems.

Regulation B's specific rules represent the Board's judgment about the general effect of selected credit practices on the population at large. When adopting the specific rules, the Board focused principally upon discriminatory practices of judgmental systems. Accordingly, the proper application of the specific rules to credit scoring systems remains unclear.

The Board invites comment on the four issues enumerated in the Summary. Resolving them could entail a variety of regulatory action, including amending Regulation B and issuing official interpretations. Before considering any extensive changes, the Board wishes to encourage a thorough public discussion that will address both the impact of possible changes and the need for any change at all. The options described for each issue are not mutually exclusive and do not constitute the only possible responses. The Board also solicits comment on the general subject of applying Regulation B's specific rules to credit scoring systems. After analysis of the comments received, the Board will determine what issues, if any, warrant its further consideration and what regulatory action appears appropriate.

1. In developing and using a credit scoring system, what constitutes discounting of income and what constitutes exclusion of consideration of income?

Section 202.6(b)(5) provides that a "creditor shall not discount or exclude from consideration the income of an applicant . . . because the income is derived from part-time employment . . . ." However, the "creditor may consider the amount and probable continuance of any income . . . ." The Board adopted this rule to prevent discrimination against married women, many of whom work only part-time, and to curtail the practice of arbitrarily discounting the wife's income on joint applications. For a judgmental system, the rule means that the credit officer must accord reliable amounts of part-time income the same treatment given income from any other source. The Board did not consider how the rule should affect credit scoring systems.

1a. For example, may a credit scoring system score the fact that an applicant has more than one job or multiple sources of income, and may it score secondary income differently from primary income?

Assuming that "number of jobs" contributes to a system's predictive power, may the system assign fewer points or less weight to applicants holding multiple jobs (e.g., one--10, two or more--5 points)? Related issues include the proper treatment of the number of income sources and of the amount of income from different types of sources (earned, alimony, pension, dividend, etc.). The Board recognizes that these issues involve competing considerations and that how the question is phrased to some extent dictates the answer.

For example, those who would prohibit assigning negative points for multiple jobs argue that this practice has the effect of disadvantaging several protected classes of applicants. In addition, the literal text of the § 202.6(b)(5) rule could be interpreted to preclude discounting part-time income by type, as well as amount. Finally, to penalize an applicant for fully completing the application (e.g., providing information about part-time employment) may simply seem undersirable when selective omissions (e.g., not providing part-time employment information) would confer a greater probability of obtaining credit.

Conversely, proponents of the practice might show that "number of jobs" predicts creditworthiness. Prohibiting its use reduces system accuracy and therefore increases the aggregate risk of extending credit. Further, the regulation refers to the amount of part-time income, not its mere existence. Finally, the practice of assigning less weight to second jobs may not have the effect of discriminating on a prohibited basis since all manner of applicants "moonlight."

The Board hopes that public comments will bring additional considerations to its attention. At present, it contemplates one or more of the following options for addressing this issue.

A. Interpreting § 202.6(b)(5) as applying only to judgmental systems, thereby authorizing scoring number of jobs.

B. Interpreting the rule to prohibit scoring number of jobs, number of sources of income, or amount of income from different sources.

C. Interpreting the rule as not per se prohibiting the practice, but allowing ECOA enforcement agencies to determine on a case by case basis whether scoring number of jobs or sources of income has the effect of impermissibly discriminating against an applicant on a prohibited basis.

1b. How must a scoring system consider the amount of an applicant's income from part-time employment, pension, or alimony?

Section 202.6(b)(5)'s prohibition on excluding part-time income from consideration also applies to pension and alimony income. These additional provisions seek to protect divorced women and the elderly from discrimination unrelated to their creditworthiness. When adopting them, the Board concentrated on arbitrary behavior by judgmental creditors. It now solicits comment on how this specific rule should apply to credit scoring systems.

Development of a scoring system typically uses statistical techniques to select the characteristics that, taken together, predict the repayment performance of the creditor's recent applicants. A properly designed development process may examine and reject other characteristics as nonpredictive. If secondary income does not contribute to the creditworthiness prediction, must the system score it anyway, or would having included secondary income as a trial characteristic during the initial phases of the development procedure suffice?

Proponents of scoring nonpredictive secondary income interpret § 202.6(b)(5) as requiring explicit treatment of these types of secondary income. They also point out that the section contemplates an individual analysis of the particular applicant's income and precludes assumptions based upon the experience with similar income of prior applicants. Thus, the creditor must consider the fact that a particular applicant can prove the regular receipt of alimony, even if most applicants' alimony does not arrive on schedule.

Opponents object to this interpretation as overliteral. The Board adopted the rule to deter credit officers from using stereotypes in lieu of individual analysis when dealing with divorcees, the elderly, and married women. A scoring system, however, uses only the combination of characteristics that best associate with creditworthiness. If secondary income does not statistically associate with creditworthiness, the government should not make it do so. Requiring a creditor to score a nonpredictive characteristic distorts the validity of the credit analysis process. This increases the creditor's overall risk of doing business and may result in less credit to economically disadvantaged applicants.

to economically disadvantaged applicants.

The Board invites comment on the issue of how a scoring system should consider the amount of an applicant's income from part-time employment, pension, or alimony, and on possible alternatives for addressing it, including:

A. Exempting credit scoring from the "consideration" rule in § 202.6(b)(5).

B. Deeming inclusion of secondary income as a trial characteristic in the system development process to constitute sufficient consideration.

C. Requiring that any scoring of amount of income include all types of income as a single characteristic.

D. Requiring that scoring systems have a judgmental override that considers secondary income.

E. Requiring positive allocation of points to secondary income regardless of its predictive power.

F. Requiring systems to include a subsystem that predicts the reliability of the particular applicant's secondary income.

2. How must a creditor using a scoring system select the "specific" reasons for adverse action?

The ECOA and Regulation B provide that, when a creditor takes "adverse action" (e.g., by rejecting a credit request), it must give the applicant either the specific reasons for the action or a disclosure of the right to receive the reasons. Section 202.9(b)(2) of the regulation requires that a statement of reasons suffices if "specific and indicates the principal reasons for the adverse action." A statement that the applicant failed to achieve a passing score does not suffice as a specific reason. Receiving the reasons for adverse action gives applicants an opportunity to take remedial action, correct erroneous assumptions of the creditor, and reapply when a mutable attribute changes (e.g., when income increases).

Recent FTC consent decrees contain a requirement that users of scoring systems select their reasons for adverse action using a specified mathematical formula. Under these decrees, the creditor must examine the scoring sheet for the rejected application, subtract the applicant's score from the median score for each characteristic, and disclose the four characteristics having the largest differences. The Board's staff, on the other hand, has unofficially interpreted § 202.9(b)(2) to permit judgmental selection of reasons for adverse action, even by creditors using scoring. Thus, the credit officer may select the reasons from all the information on the application.

Proponents of the former interpretation argue that the scored characteristics alone contribute to the credit decision, and that therefore they comprise the real reasons for adverse action. Permitting the creditor to disclose unscored characteristics from the balance of an application does not provide information the applicant can use to take remedial action. ECOA enforcement agencies also suggest that some creditors use judgmental selection of reasons to conceal discriminatory credit analysis practices. By manually selecting among all the information on the application, they intentionally mislead applicants about the true reasons for their rejection.

Opponents of the mathematical process reason that under a judgmental system the credit officer makes the credit decision and selects the reasons manually. The same officer can also select the reasons where a scoring system makes the initial decision. In addition, some important reasons occur too infrequently for inclusion on the scoring sheet (e.g., bankruptcy), but would be selected by judgmental systems as critical. Finally, a suitable method for selecting reasons for adverse action will vary from case to case, depending upon the nature of the particular credit analysis process. A fixed, mathematical procedure may prove unsuitable in certain cases. For example, a scoring system that allocates half of its possible points for a single characteristic would select this characteristic as the reason so frequently as to obscure its specificity as a reason.

The Board hopes that public comment will more fully explore these considerations. It suggests the availability of a variety of approaches to the problem.

A. Authorizing either mathematical or judgmental selection of reasons for adverse action.

B. Requiring judgmental selection.

C. Requiring that applicants with similar financial characteristics receive similar reasons, but not specifying the method for selecting them.

D. Specifying the exact formula for relating scored characteristics to selection of reasons for adverse action.

3. Under what circumstances may a creditor employing a credit scoring system use the reasons for adverse action from Regulation B's model statement?

As noted above, the statute and § 202.9(b)(2) require disclosure of "specific" reasons for adverse action. Section 202.9(b)(2) also provides a model "statement of credit denial, termination, or change," proper use of which satisfies this requirement. The model statement contains twenty categories of reasons for adverse action, including "other, specify." The Board adopted the model statement to facilitate compliance by small creditors.

ECOA enforcement agencies have experienced some difficulties in the specificity with which model reasons must correspond to scored characteristics while still amounting to proper use. The problem arises because scored characteristics have greater specificity than the "pertinent elements of creditworthiness" used in a typical judgmental system. For example, a creditor might score: finance company loans, yes--0, no--15; bank loans, yes—6, no—1; or credit cards from prestigious department stores, none--0, one--4, two or more--16. None of the reasons on the model notice relate closely to any of these specific characteristics. Instead of filling in the "other, specify" line, a creditor may check whichever reason seems to be closest (e.g., insufficient credit references).

Critics of this practice suggest that forcing specific characteristics into model categories of reasons violates the requirement of specificity. The practice of discounting finance company loans relates only indirectly to insufficient credit references. In addition, this mischaracterization or lack of specificity deprives rejected applicants of the opportunity to remedy their credit deficiencies. The critics argue that it therefore constitutes a misuse of the model statement and does not satisfy the specific rule's requirements. Finally, ECOA enforcement agencies suggest that some creditors use the model reasons to mislead applicants about the characteristics scored in order to conceal discriminatory practices. The agencies believe that precise restrictions on proper use of the model statement will reduce this abuse.

Conversely, the legislative history accompanying ECOA indicates that the Congress contemplated only the most general statement of reasons. One of the examples in the legislative history contains only seven reasons.

Requiring that disclosed reasons for adverse action correspond exactly to scored characteristics will also disrupt the present operations of creditors that use scoring. Changing procedures and forms will entail extra compliance costs. In addition, increased specificity will mean greater uncertainty as creditors grope to comply with a new standard that lacks precise quantification. How specific is "specific"? Finally, using the model statement to evade the regulation presently constitutes a violation, and the enforcement tools for dealing with such practices already exist.

The Board perceives the question as being one of degree. Consider a system that scores the number of credit references from banks. An applicant with six references from stores, finance companies, and thrift institutions receives no points for them. Checking "insufficient credit references" on the adverse action notice seems insufficiently specific. Disclosing "no bank references" probably would suffice. What intermediate levels of specificity also comply with the requirements of a statement of specific reasons for adverse action, and how can the Board precisely articulate them? The Board envisions one or more of the following alternatives.

A. Increasing the number of reasons on the model statement.

B. Prohibiting creditors that use scoring systems from utilizing the model statement.

C. Deeming "specific" to be the general standard and leaving it to each enforcement authority to determine whether a particular reason conforms to this standard.

D. Promulgating more precise standards for relating scored characteristics to specificity of reasons for adverse action, but leaving the model statement unchanged.

E. Requiring creditors that use scoring systems to disclose that they use scoring, the exact characteristics scored, and the four characteristics for which the applicant lost the most points, in lieu of using the model statement.

Pursuant its authority under § 703 of ECOA, the Board proposes to adopt one or more of the following amendments to Regulation B. The amendments appear sequentially by issue and option. The proposed new language is in italics.

Issue 1a: Section 202.6(b)(5) would be amended to read:

Option A: *In a judgmental system*, a creditor shall not discount or exclude from consideration . . . .

Option B: A creditor shall not discount or exclude from consideration the income of an applicant or the spouse of an applicant because of a prohibited basis or because *of the amount or type of income* derived from part-time employment . . . .

Option C: A creditor shall not discount or exclude from consideration the *amount of* income of an applicant or . . . .

Issue 1b: Section 202.6(b)(5) would be amended to read:

Option A: *In a judgmental system*, a creditor shall not discount or exclude from consideration . . . .

Option B: . . . in evaluating an applicant's creditworthiness. *A demonstrably and statistically sound, empirically derived credit system may consider this income by including it as a trial characteristic during the system construction process*. Where an applicant relies . . . .

Option C: *In a judgmental system*, a creditor shall not discount or exclude from consideration . . . . *In a demonstrably and statistically sound, empirically derived credit* system that considers the amount of income of an applicant or the spouse of an applicant, the creditor shall consider all reliable income as a single characteristic. Where an applicant relies . . . .

Option D: . . . in evaluating an applicant's creditworthiness. A demonstrably and statistically sound, empirically derived credit system shall comply with this requirement by using a judgmental override that considers such income. Where an applicant relies . . . .

Option E: . . . in evaluating an applicant's creditworthiness. A demonstrably and statistically sound, empirically derived credit system shall comply with this requirement by allocating at least x per cent of the possible total points to receipt of such income.

Issue 2: Section 202.9(b)(2) would be amended to add a new sentence at its end:

Option A: A creditor may select the reasons either judgmentally or by using a mathematical formula.

Option B: A creditor using a demonstrably and statistically sound, empirically derived credit system shall select the reason(s) judgmentally.

Option C: A creditor using a demonstrably and statistically sound, empirically derived credit system shall select the reason(s) using a procedure that will result in applicants with similar financial characteristics receiving identical reasons.

Option D: A creditor using a demonstrably and statistically sound, empirically derived credit system shall select as reasons up to four characteristics on which the applicant's score differed most from the maximum possible score.

Issue 3: Section 202.9(b)(2) would be amended as follows:

Option B: . . . for the adverse action. A judgmental creditor may use all or a portion of the sample form printed below . . . .

Option D: . . . for the adverse action. A statement's reasons are specific if a reasonable consumer receives sufficient information to determine the changes in characteristics that would have resulted in approval of the application. A creditor may formulate . . . .

Option E: . . . for the adverse action. A judgmental creditor may formulate its own statement of reasons . . . . A creditor using a demonstrably and statistically sound, empirically derived credit system must disclose the use of the system, the manner of its operation, the applicant's score, the passing score, the maximum possible score, and the characteristics scored.

* * * *

By order of the Board of Governors, April 13, 1979.

(signed) Theodore E. Allison

Theodore E. Allison
Secretary of the Board

[SEAL]

FEDERAL RESERVE
press release

For immediate release July 24, 1979

The Federal Reserve Board today made public, as an aid to discussion, the attached staff paper on the issues involved in the Board's request for public comment on how the anti-discrimination rules of Regulation B can be applied to credit scoring.

Regulation B implements the Equal Credit Opportunity Act, which forbids discrimination in the granting of credit on grounds of sex, marital status, age, race, religion and other grounds.

The staff paper emphasizes that the Board's purpose in requesting comment on the application of Regulation B to credit scoring was to make the Regulation a more effective tool for eliminating discrimination in credit granting.

The paper, which is attached, describes credit scoring and provides an analysis of the issues on which the Board requested comment with respect to credit scoring.

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July 17, 1979

Issues on Which the Federal Reserve Board Seeks Comment on its April 19 Request for Suggestions on How Regulation B Can be Made to Apply More Effectively to Credit Scoring

A number of commenters have asked for a non-technical explanation of issues involved in the Board's April 19 request for comment on how the specific rules of Regulation B should apply to four practices of creditors using credit scoring systems. This memorandum was prepared by Board staff in order to help commenters who do not have a technical background address some of the principal issues of the request for comment published on April 19. While it would be appreciated if any comment on those proposals could be received by August 20, any comment received while staff is analyzing the response to the proposals will be fully considered. Comments should be addressed to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551. All comments should refer to docket number R-203.

BACKGROUND

The need to focus the regulation more specifically on credit scoring. It must be emphasized that the purpose of the Board's request for comment was to strengthen the regulation and not to remove any existing protections against discrimination in credit transactions. When Regulation B was adopted, the Board focussed primarily on discriminatory practices under the judgmental systems used by the vast majority of creditors--that is to say, systems which grant or deny credit on the basis of the remembered experience and subjective intuitions of individual credit-grantors. At that time, the Board had general knowledge about the way in which credit scoring systems operated, but little information about specific scoring practices. Except for some rules relating to age, the regulation was not designed to accommodate the special problems posed by credit scoring.

Since that time, the Board and its staff have learned a great deal more about credit scoring. It has become increasingly apparent that the specific rules contained in the regulation to prevent discrimination under judgmental systems, have an uncertain effect on credit scoring systems. To achieve the objectives of the Equal Credit Opportunity Act and regulation, the Board may need to establish additional specific rules for scoring systems.

What is a credit scoring system? All credit analysis, whether performed judgmentally by loan officers or by credit scoring systems, is based on the principle that past credit experience predicts future credit performance. Thus it is expected that the characteristics of future creditworthy applicants will resemble recent creditworthy borrowers. Judgmental systems rely upon the experience of credit officers to identify the characteristics of past creditworthy customers that are reliable indicators of creditworthiness. A credit scoring system uses statistical methods to evaluate and compare past creditworthy and noncreditworthy applicants. This is done in order to identify those characteristics that predict creditworthiness and to assign numerical values to those characteristics. The numbers are then used to construct a combined score for individual applications to determine whether credit should be extended.

As distinct from most judgmental systems which involve a subjective appraisal of all the material in an applicant's file before credit is extended, credit scoring systems only value those characteristics that previous statistical analysis indicates are predictive of creditworthiness.

To build a statistically reliable scoring system, it is necessary to have a fairly large number of accounts--at least several thousand--with which a particular creditor has had actual experience. It is important to note that the experience of one creditor can be very different from that of another, and that accounts of even different branches of the same creditor can differ widely, so that ordinarily each one must build its own system in order to get acceptable results.

The accounts are divided into 'goods' and 'bads', i.e., into accounts that have paid satisfactorily and those that have defaulted. Then all the information is taken that was known about each applicant at the time of application. This usually includes information on the application itself and information from a credit report if the creditor obtained a report. Each item of information is recorded, for example, number of years on job, whether the applicant has a telephone in the home, age of applicant, amount of income, whether the applicant owns or rents, and so forth.

A point to emphasize is that the particular items of information that are on the applications and hence available to build the system may differ from creditor to creditor. There is no uniform set of items that all creditors do in fact take into account when making a credit decision. Also, there is no uniformity as to which items of information will turn out to predict, for any particular creditor or applicant population, whether or not an applicant will pay back the credit on time.

In order to find out which items will best predict customer behavior each item of information is also tabulated to show how often it occurs on 'good' and on 'bad' accounts, either alone or in combination with other items. Then the tabulations are analyzed statistically to see how much more often each item or combination occurs in one group or the other. If, for example, 'telephone in home', turns up much more frequently in 'good' than in 'bad' accounts, then that item becomes a candidate to be included in a scoring system.

When all the items have been evaluated to identify those which are most useful in identifying accounts that are likely to pay on time each one that is selected is given a numerical value reflecting how useful it is for that purpose. No fixed number of items is used, but ten or a dozen items might be typical. When the numbers are added up it becomes possible to determine how likely it is that an application with a given 'score' will result in an account that will pay on time

The creditor using a credit scoring system has a business incentive to lend as much as possible, so long as losses from default do not reduce profits below an acceptable level. By setting the score higher or lower, the creditor can affect the amount that will be lent and also affect the amount of losses. The higher the required score, the less the risk of loss, but the less credit will be extended. Many creditors set a minimum score below which credit will not be granted and a higher number above which credit will be granted automatically. Then they do further checking on applications whose scores fall into the medium range and make a judgmental decision based on the further checking.

ISSUES

How to make certain that applicants have all their reliable income considered? Regulation B forbids the discounting of income that is reliable simply because the income is part-time, or derived from some source of which creditors may have traditionally been suspicious, such as pensions, child support, or alimony. Applicants need not declare alimony, child support, or separate maintenance, but if they choose to do so the creditor can ask if it is paid regularly but cannot discount it because of its source.

There are certain difficulties, however, in implementing this principle in credit scoring systems. Some of the factors that the Board must consider in deciding if the regulation should be amended are as follows.

First, there are a number of credit scoring systems which do not take income into account at all. In these systems, other items of information have been found to be more predictive or data on income were not collected in the first place.

Another factor is that some creditors, in building credit scoring systems, have found that taking 'secondary' income into account does not improve the predictive value of the system. This could perhaps result from the way in which the systems are built. For example, if a creditor did not evaluate the likelihood that alimony, when it appeared on an application would be paid regularly, but simply tabulated the presence of alimony as a factor to be used in building a system, it might be that—because it is often not reliable--alimony would turn out not to have predictive value. The Board hopes to obtain more factual information about how such systems have actually been built. It also hopes to receive comment on what sort of rules would be most likely to result in all reliable income being considered, in systems that do use income as a predictive item.

Are the protected classes more likely, or not, to have two or more jobs? Some creditors have found that holding more than one job is a factor that is more likely to be associated with non-payment of credit. Persons who have borrowed on the assumption that they will be able to continue to work on two or more jobs may find themselves less able to repay if they must give up one. Are minorities, women, the elderly, or persons belonging to particular religious groups, more likely than the general population to hold more than one job? Is this a factor which creditors should not be permitted to take into consideration in building a credit scoring system? Or is it neutral, so that if holding more than one job turns out to be a predictive for a particular creditor, it could be used?

What kind of explanation is specific enough to satisfy the regulation for applicants who have been denied credit because their score is not high enough? The Act requires that applicants be given the specific reasons when they are denied credit. There are several reasons for this requirement. One is so that the applicant can correct any mistakes that may have been made in evaluating the application. For example, the credit history may be incomplete, or contain a mistake, or may even belong to a different person with a similar name. Another reason is to help applicants learn what they can do to make themselves more creditworthy. Also, it is believed that disclosure tends to prevent arbitrary credit decisions

The first purpose is not difficult to achieve. Applicants provide the information on applications. The Fair Credit Reporting Act already requires that applicants who are denied credit must be told if a credit bureau report was obtained by the creditor and how to contact the credit bureau in order to verify the information on the history.

The second purpose is more difficult to achieve. The specific details of credit scoring systems have been kept secret partly because the systems are expensive to build and creditors do not want to share them with their competitors. More important, creditors fear that if the complete system were public information, it would be too easy for people who were poor credit risks or who actually wanted to defraud the creditor to falsify their applications in order to reach a passing score. The question is, how can anything less than a full outline of the system help applicants improve their credit rating?

A number of alternative suggestions have been made. The Federal Trade Commission has obtained agreements from some creditors to disclose the four items on which the applicant fell further below the maximum or median number of points that could be awarded. Other variations have been suggested for selecting what seem the most significant items. Another suggestion is that creditors explain that the total score is not sufficient, which is closest to a scientifically correct answer, but not very helpful, and illegal under the statute and regulation. Another suggestion that has been made is to forbid the use of credit scoring. But while it is very important to eliminate bias and prejudice from the way in which scoring systems are built (for example, using the Zip code in an applicant's address, where Zip code correlates with race), properly built scoring systems can help get away from the subjective prejudices of individual credit grantors. This is because the system exists in black and white and can be checked; the criteria used by individual credit grantors are much harder to pin down and verify.

CONCLUSION

The Board has asked for comment on all the issues discussed above, with a view to finding out how Regulation B can be made most effective as a tool for eliminating discrimination in the credit granting process, where credit scoring is used. All comments received will be carefully considered.

APPENDIX 10

EXCERPTS FROM THE CIVIL RIGHTS ACT OF 1968

Public Law 90-284
90th Congress, H.R. 2516
April 11, 1968

An Act

To prescribe penalties for certain acts of violence or intimidation, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled. Civil rights.

• • •

TITLE VIII—FAIR HOUSING [*]

POLICY

SEC. 801. It is the policy of the United States to provide, within constitutional limitations, for fair housing throughout the United States. 42 USC 3601.

DEFINITIONS

SEC. 802. As used in this title—

(a) "Secretary" means the Secretary of Housing and Urban Development.

(b) "Dwelling" means any building, structure, or portion thereof which is occupied as, or designed or intended for occupancy as, a residence by one or more families, and any vacant land which is offered for sale or lease for the construction or location thereon of any such building, structure, or portion thereof.

(c) "Family" includes a single individual.

(d) "Person" includes one or more individuals, corporations, partnerships, associations, labor organizations, legal representatives, mutual companies, joint-stock companies, trusts, unincorporated organizations, trustees, trustees in bankruptcy, receivers, and fiduciaries.

(e) "To rent" includes to lease, to sublease, to let and otherwise to grant for a consideration the right to occupy premises not owned by the occupant.

(f) "Discriminatory housing practice" means an act that is unlawful under section 804, 805, or 806.

(g) "State" means any of the several States, the District of Columbia, the Commonwealth of Puerto Rico, or any of the territories and possessions of the United States.

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[*] Note Title VIII, as amended by Section 808(b) (1), (2), and (3) of the Housing and Community Development Act of 1974, Public Law 93-383, 93rd Congress, August 22, 1974.

EFFECTIVE DATES OF CERTAIN PROHIBITIONS

SEC. 803. (a) Subject to the provisions of subsection (b) and section 807, the prohibitions against discrimination in the sale or rental of housing set forth in section 804 shall apply:

(1) Upon enactment of this title, to—

(A) dwellings owned or operated by the Federal Government;

(B) dwellings provided in whole or in part with the aid of loans, advances, grants, or contributions made by the Federal Government, under agreements entered into after November 20, 1962, unless payment due thereon has been made in full prior to the date of enactment of this title;

(C) dwellings provided in whole or in part by loans insured, guaranteed, or otherwise secured by the credit of the Federal Government, under agreements entered into after November 20, 1962, unless payment thereon has been made in full prior to the date of enactment of this title: *Provided*, That nothing contained in subparagraphs (B) and (C) of this subsection shall be applicable to dwellings solely by virtue of the fact that they are subject to mortgages held by an FDIC or FSLIC institution; and

FDIC or FSLIC institutions.

(D) dwellings provided by the development or the redevelopment of real property purchased, rented, or otherwise obtained from a State or local public agency receiving Federal financial assistance for slum clearance or urban renewal with respect to such real property under loan or grant contracts entered into after November 20, 1962.

(2) After December 31, 1968, to all dwellings covered by paragraph (1) and to all other dwellings except as exempted by subsection (b).

Exemptions.

(b) Nothing in section 804 (other than subsection (c)) shall apply to—

(1) any single-family house sold or rented by an owner: *Provided*, That such private individual owner does not own more than three such single-family houses at any one time: *Provided further*, That in the case of the sale of any such single-family house by a private individual owner not residing in such house at the time of such sale or who was not the most recent resident of such house prior to such sale, the exemption granted by this subsection shall apply only with respect to one such sale within any twenty-four month period: *Provided further*, That such bona fide private individual owner does not own any interest in, nor is there owned or reserved on his behalf, under any express or voluntary agreement, title to any right to all or a portion of the proceeds from the sale or rental of, more than three such single-family houses at any one time: *Provided further*, That after December 31, 1969, the sale or rental of any such single-family house shall be excepted from the application of this title only if such house is sold or rented (A) without the use in any manner of the sales or rental facilities or the sales or rental services of any real estate broker, agent, or salesman, or of such facilities or services of any person in the business of selling or renting dwellings, or of any employee or agent of any such broker, agent, salesman, or person and (B) without the publication, posting or

mailing, after notice, of any advertisement or written notice in violation of section 804(c) of this title; but nothing in this proviso shall prohibit the use of attorneys, escrow agents, abstractors, title companies, and other such professional assistance as necessary to perfect or transfer the title, or

(2) rooms or units in dwellings containing living quarters occupied or intended to be occupied by no more than four families living independently of each other, if the owner actually maintains and occupies one of such living quarters as his residence.

(c) For the purposes of subsection (b), a person shall be deemed to be in the business of selling or renting dwellings if—

(1) he has, within the preceding twelve months, participated as principal in three or more transactions involving the sale or rental of any dwelling or any interest therein, or

(2) he has, within the preceding twelve months, participated as agent, other than in the sale of his own personal residence in providing sales or rental facilities or sales or rental services in two or more transactions involving the sale or rental of any dwelling or any interest therein, or

(3) he is the owner of any dwelling designed or intended for occupancy by, or occupied by, five or more families.

DISCRIMINATION IN THE SALE OR RENTAL OF HOUSING

SEC. 804. As made applicable by section 803 and except as exempted by sections 803(b) and 807, it shall be unlawful—

(a) To refuse to sell or rent after the making of a bona fide offer, or to refuse to negotiate for the sale or rental of, or otherwise make unavailable or deny, a dwelling to any person because of race, color, religion, sex, or national origin.

(b) To discriminate against any person in the terms, conditions, or privileges of sale or rental of a dwelling, or in the provision of services or facilities in connection therewith, because of race, color, religion, sex, or national origin.

(c) To make, print, or publish, or cause to be made, printed, or published any notice, statement, or advertisement, with respect to the sale or rental of a dwelling that indicates any preference, limitation, or discrimination based on race, color, religion, sex, or national origin, or an intention to make any such preference, limitation, or discrimination.

(d) To represent to any person because of race, color, religion, sex, or national origin that any dwelling is not available for inspection, sale, or rental when such dwelling is in fact so available.

(e) For profit, to induce or attempt to induce any person to sell or rent any dwelling by representations regarding the entry or prospective entry into the neighborhood of a person or persons of a particular race, color, religion, sex, or national origin.

DISCRIMINATION IN THE FINANCING OF HOUSING

SEC. 805. After December 31, 1968, it shall be unlawful for any bank, building and loan association, insurance company or other corporation, association, firm or enterprise whose business consists in whole or in part in the making of commercial real estate loans, to deny a loan or other financial assistance to a person applying therefor for the purpose of purchasing, constructing, improving, repairing, or maintaining a dwelling, or to discriminate against him in the fixing of the amount, interest rate, duration, or other terms or conditions of such loan or other financial assistance, because of the race, color, religion, sex, or national origin of such person or of any person associated with him in connection with such loan or other financial assistance or the purposes of such loan or other financial assistance, or of the present or prospective owners, lessees, tenants, or occupants of the dwelling or dwellings in relation to which such loan or other financial assistance is to be made or given: *Provided*, That nothing contained in this section shall impair the scope or effectiveness of the exception contained in section 803(b).

DISCRIMINATION IN THE PROVISION OF BROKERAGE SERVICES

SEC. 806. After December 31, 1968, it shall be unlawful to deny any person access to or membership or participation in any multiple-listing service, real estate brokers' organization or other service, organization, or facility relating to the business of selling or renting dwellings, or to discriminate against him in the terms or conditions of such access, membership, or participation, on account of race, color, religion, sex, or national origin.

EXEMPTION

SEC. 807. Nothing in this title shall prohibit a religious organization, association, or society, or any nonprofit institution or organization operated, supervised or controlled by or in conjunction with a religious organization, association, or society, from limiting the sale, rental or occupancy of dwellings which it owns or operates for other than a commercial purpose to persons of the same religion, or from giving preference to such persons, unless membership in such religion is restricted on account of race, color, sex, or national origin. Nor shall anything in this title prohibit a private club not in fact open to the public, which as an incident to its primary purpose or purposes provides lodgings which it owns or operates for other than a commercial purpose, from limiting the rental or occupancy of such lodgings to its members or from giving preference to its members.

ADMINISTRATION

Authority and responsibility.

SEC. 808. (a) The authority and responsibility for administering this Act shall be in the Secretary of Housing and Urban Development.

Assistant Secretary.

(b) The Department of Housing and Urban Development shall be provided an additional Assistant Secretary. The Department of Housing and Urban Development Act (Public Law 89-174, 79 Stat. 667) is hereby amended by—

42 USC 3533.

(1) striking the word "four," in section 4(a) of said Act (79 Stat. 668; 5 U.S.C. 624b(a)) and substituting therefor "five,"; and

(2) striking the word "six," in section 7 of said Act (79 Stat. 669; 5 U.S.C. 624 (c)) and substituting therefor "seven."

42 USC 3535.

Delegation of authority.

(c) The Secretary may delegate any of his functions, duties, and powers to employees of the Department of Housing and Urban Development or to boards of such employees, including functions, duties, and powers with respect to investigating, conciliating, hearing, determining, ordering, certifying, reporting, or otherwise acting as to any work, business, or matter under this title. The persons to whom such delegations are made with respect to hearing functions, duties, and powers shall be appointed and shall serve in the Department of Housing and Urban Development in compliance with sections 3105, 3344, 5362, and 7521 of title 5 of the United States Code. Insofar as possible, conciliation meetings shall be held in the cities or other localities where the discriminatory housing practices allegedly occurred. The Secretary shall by rule prescribe such rights of appeal from the decisions of his hearing examiners to other hearing examiners or to other officers in the Department, to boards of officers or to himself, as shall be appropriate and in accordance with law.

80 Stat. 415, 528.

(d) All executive departments and agencies shall administer their programs and activities relating to housing and urban development in a manner affirmatively to further the purposes of this title and shall cooperate with the Secretary to further such purposes.

(e) The Secretary of Housing and Urban Development shall—

(1) make studies with respect to the nature and extent of discriminatory housing practices in representative communities, urban, suburban, and rural, throughout the United States;

(2) publish and disseminate reports, recommendations, and information derived from such studies;

(3) cooperate with and render technical assistance to Federal, State, local, and other public or private agencies, organizations, and institutions which are formulating or carrying on programs to prevent or eliminate discriminatory housing practices;

(4) cooperate with and render such technical and other assistance to the Community Relations Service as may be appropriate to further its activities in preventing or eliminating discriminatory housing practices; and

(5) administer the programs and activities relating to housing and urban development in a manner affirmatively to further the policies of this title.

EDUCATION AND CONCILIATION

SEC. 809. Immediately after the enactment of this title the Secretary shall commence such educational and conciliatory activities as in his judgment will further the purposes of this title. He shall call conferences of persons in the housing industry and other interested parties to acquaint them with the provisions of this title and his suggested means of implementing it, and shall endeavor with their advice to work out programs of voluntary compliance and of enforcement. He may pay per diem, travel, and transportation expenses for persons attending such

80 Stat. 499.

Reports on conferences.

conferences as provided in section 5703 of title 5 of the United States Code. He shall consult with State and local officials and other interested parties to learn the extent, if any, to which housing discrimination exists in their State or locality, and whether and how State or local enforcement programs might be utilized to combat such discrimination in connection with or in place of, the Secretary's enforcement of this title. The Secretary shall issue reports on such conferences and consultations as he deems appropriate.

ENFORCEMENT

Complaints. Procedure for filing.

Penalty.

SEC. 810. (a) Any person who claims to have been injured by a discriminatory housing practice or who believes that he will be irrevocably injured by a discriminatory housing practice that is about to occur (hereafter "person aggrieved") may file a complaint with the Secretary. Complaints shall be in writing and shall contain such information and be in such form as the Secretary requires. Upon receipt of such a complaint the Secretary shall furnish a copy of the same to the person or persons who allegedly committed or are about to commit the alleged discriminatory housing practice. Within thirty days after receiving a complaint, or within thirty days after the expiration of any period of reference under subsection (c), the Secretary shall investigate the complaint and give notice in writing to the person aggrieved whether he intends to resolve it. If the Secretary decides to resolve the complaint, he shall proceed to try to eliminate or correct the alleged discriminatory housing practice by informal methods of conference, conciliation, and persuasion. Nothing said or done in the course of such informal endeavors may be made public or used as evidence in a subsequent proceeding under this title without the written consent of the persons concerned. Any employee of the Secretary who shall make public any information in violation of this provision shall be deemed guilty of a misdemeanor and upon conviction thereof shall be fined not more than $1,000 or imprisoned not more than one year.

(b) A complaint under subsection (a) shall be filed within one hundred and eighty days after the alleged discriminatory housing practice occurred. Complaints shall be in writing and shall state the facts upon which the allegations of a discriminatory housing practice are based. Complaints may be reasonably and fairly amended at any time. A respondent may file an answer to the complaint against him and with the leave of the Secretary, which shall be granted whenever it would be reasonable and fair to do so, may amend his answer at any time. Both complaints and answers shall be verified.

(c) Wherever a State or local fair housing law provides rights and remedies for alleged discriminatory housing practices which are substantially equivalent to the rights and remedies provided in this title, the Secretary shall notify the appropriate State or local agency of any complaint filed under this title which appears to constitute a violation of such State or local fair housing law, and the Secretary shall take no further action with respect to such complaint if the appropriate State or local law enforcement official has, within thirty days from the date the alleged offense has been brought to his attention, commenced proceedings in the matter, or, having done so, carries forward such proceedings with reasonable promptness. In no event shall the Secretary take further action unless he certifies that in his judgment, under the circumstances of the particular case, the protection of the rights of the parties or the interests of justice require such action.

Commencement of civil actions.

(d) If within thirty days after a complaint is filed with the Secretary or within thirty days after expiration of any period of reference under subsection (c), the Secretary has been unable to obtain voluntary compliance with this title, the person aggrieved may, within thirty days thereafter, commence a civil action in any appropriate United States district court, against the respondent named in the complaint, to enforce the rights granted or protected by this title, insofar as such rights relate to the subject of the complaint: *Provided*, That no such civil action may be brought in any United States district court if the person aggrieved has a judicial remedy under a State or local fair housing law which provides rights and remedies for alleged discriminatory housing practices which are substantially equivalent to the rights and remedies provided in this title. Such actions may be brought without regard to the amount of controversy in any United States district court for the district in which the discriminatory housing practice is alleged to have occurred or be about to occur or in which the respondent resides or transacts business. If the court finds that a discriminatory housing practice has occurred or is about to occur, the court may, subject to the provisions of section 812, enjoin the respondent from engaging in such practice or order such affirmative action as may be appropriate.

(e) In any proceeding brought pursuant to this section, the burden of proof shall be on the complainant.

(f) Whenever an action filed by an individual, in either Federal or State court, pursuant to this section or section 812, shall come to trial the Secretary shall immediately terminate all efforts to obtain voluntary compliance.

INVESTIGATIONS; SUBPENAS; GIVING OF EVIDENCE

Records and documents, access.

SEC. 811. (a) In conducting an investigation the Secretary shall have access at all reasonable times to premises, records, documents, individuals, and other evidence or possible sources of evidence and may examine, record, and copy such materials and take and record the testimony or statements of such persons as are reasonably necessary for the furtherance of the investigation: *Provided*, however, That the Secretary first complies with the provisions of the Fourth Amendment relating to unreasonable searches and seizures. The Secretary may issue subpenas to compel his access to or the production of such materials, or to the appearance of such persons, and may issue interrogatories to a respondent, to the same extent and subject to the same limitations as would apply if the subpenas or interrogatories were issued or served in aid of a civil action in the United States district court for the district in which the investigation is taking place. The Secretary may administer oaths.

Subpenas.

(b) Upon written application to the Secretary, a respondent shall be entitled to the issuance of a reasonable number of subpenas by and in the name of the Secretary to the same extent and subject to the same limitations as subpenas issued by the Secretary himself. Subpenas issued at the request of a respondent shall show on their face the name and address of such respondent and shall state that they were issued at his request.

Witnesses, compensation.

(c) Witnesses summoned by subpena of the Secretary shall be entitled to the same witness and mileage fees as are witnesses in proceedings in United States district courts. Fees payable to a witness summoned by a subpena issued at the request of a respondent shall be paid by him.

(d) Within five days after service of a subpena upon any person, such person may petition the Secretary to revoke or modify the subpena. The Secretary shall grant the petition if he finds that the subpena requires appearance or attendance at an unreasonable time or place, that it requires production of evidence which does not relate to any matter under investigation, that it does not describe with sufficient particularity the evidence to be produced, that compliance would be unduly onerous, or for other good reason.

(e) In case of contumacy or refusal to obey a subpena, the Secretary or other person at whose request it was issued may petition for its enforcement in the United States district court for the district in which the person to whom the subpena was addressed resides, was served, or transacts business.

Failure to testify, penalty.

(f) Any person who willfully fails or neglects to attend and testify or to answer any lawful inquiry or to produce records, documents, or other evidence, if in his power to do so, in obedience to the subpena or lawful order of the Secretary, shall be fined not more than $1,000 or imprisoned not more than one year, or both. Any person who, with intent thereby to mislead the Secretary, shall make or cause to be made any false entry or statement of fact in any report, account, record, or other document submitted to the Secretary pursuant to his subpena or other order, or shall willfully neglect or fail to make or cause to be made full, true, and correct entries in such reports, accounts, records, or other documents, or shall willfully mutilate, alter, or by any other means falsify any documentary evidence, shall be fined not more than $1,000 or imprisoned not more than one year, or both.

(g) The Attorney General shall conduct all litigation in which the Secretary participates as a party or as amicus pursuant to this Act.

ENFORCEMENT BY PRIVATE PERSONS

SEC. 812. (a) The rights granted by sections 803, 804, 805, and 806 may be enforced by civil actions in appropriate United States district courts without regard to the amount in controversy and in appropriate State or local courts of general jurisdiction. A civil action shall be commenced within one hundred and eighty days after the alleged discriminatory housing practice occurred: *Provided, however*, That the court shall continue such civil case brought pursuant to this section or section 810(d) from time to time before bringing it to trial if the court believes that the conciliation efforts of the Secretary or a State or local agency are likely to result in satisfactory settlement of the discriminatory housing practice complained of in the complaint made to the Secretary or to the local or State agency and which practice forms the basis for the action in court: *And provided, however,* That any sale, encumbrance, or rental consummated prior to the issuance of any court order issued under the authority of this Act, and involving a bona fide purchaser, encumbrancer, or tenant without actual notice of the existence of the filing of a complaint or civil action under the provisions of this Act shall not be affected.

Civil action without fees, etc.

(b) Upon application by the plaintiff and in such circumstances as the court may deem just, a court of the United States in which a civil action under this section has been brought may appoint an attorney for the plaintiff and may authorize the commencement of a civil action upon proper showing without the payment of fees, costs, or security. A court of a State or subdivision thereof may do likewise to the extent not inconsistent with the law or procedures of the State or subdivision.

Damages, limitation.

(c) The court may grant as relief, as it deems appropriate, any permanent or temporary injunction, temporary restraining order, or other order, and may award to the plaintiff actual damages and not more than $1,000 punitive damages, together with court costs and reasonable attorney fees in the case of a prevailing plaintiff: *Provided,* That the said plaintiff in the opinion of the court is not financially able to assume said attorney's fees.

ENFORCEMENT BY THE ATTORNEY GENERAL

SEC. 813. (a) Whenever the Attorney General has reasonable cause to believe that any person or group of persons is engaged in a pattern or practice of resistance to the full enjoyment of any of the rights granted by this title, or that any group of persons has been denied any of the rights granted by this title and such denial raises an issue of general public importance, he may bring a civil action in any appropriate United States district court by filing with it a complaint setting forth the facts and requesting such preventive relief, including an application for a permanent or temporary injunction, restraining order, or other order against the person or persons responsible for such pattern or practice or denial of rights, as he deems necessary to insure the full enjoyment of the rights granted by this title.

EXPEDITION OF PROCEEDINGS

SEC. 814. Any court in which a proceeding is instituted under section 812 or 813 of this title shall assign the case for hearing at the earliest practicable date and cause the case to be in every way expedited.

EFFECT ON STATE LAWS

SEC. 815. Nothing in this title shall be construed to invalidate or limit any law of a State or political subdivision of a State, or of any other jurisdiction in which this title shall be effective, that grants, guarantees, or protects the same rights as are granted by this title; but any law of a State, a political subdivision, or other such jurisdiction that purports to require or permit any action that would be a discriminatory housing practice under this title shall to that extent be invalid.

COOPERATION WITH STATE AND LOCAL AGENCIES ADMINISTERING FAIR HOUSING LAWS

SEC. 816. The Secretary may cooperate with State and local agencies charged with the administration of State and local fair housing laws and, with the consent of such agencies, utilize the services of such agencies and their employees and, not withstanding any other provision of law, may reimburse such agencies and their employees for services rendered to assist him in carrying out this title. In furtherance of such cooperative efforts, the Secretary may enter into written agreements with such State or local agencies. All agreements and terminations thereof shall be published in the Federal Register.

Publication in Federal Register.

INTERFERENCE, COERCION, OR INTIMIDATION

SEC. 817. It shall be unlawful to coerce, intimidate, threaten, or interfere with any person in the exercise or enjoyment of, or on account of his having exercised or enjoyed, or on account of his having aided or encouraged any other person in the exercise or enjoyment of, any right granted or protected by section 803, 804, 805, or 806. This section may be enforced by appropriate civil action.

APPROPRIATIONS

SEC. 818. There are hereby authorized to be appropriated such sums as are necessary to carry out the purposes of this title.

SEPARABILITY OF PROVISIONS

SEC. 819. If any provisions of this title or the application thereof to any person or circumstances is held invalid, the remainder of the title and the application of the provision to other persons not similarly situated or to other circumstances shall not be affected thereby.

TITLE IX [*]

PREVENTION OF INTIMIDATION IN FAIR HOUSING CASES

SEC. 901. Whoever, whether or not acting under color of law, by force or threat of force willfully injures, intimidates or interferes with, or attempts to injure, intimidate or interfere with—

(a) any person because of his race, color, religion, sex, or national origin and because he is or has been selling, purchasing, renting, financing, occupying, or contracting or negotiating for the sale, purchase, rental, financing or occupation of any dwelling, or applying for or participating in any service, organization, or facility relating to the business of selling or renting dwellings; or

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* Note. Title IX, as amended by Section 808(b)(4) of the Housing and Community Development Act of 1974, Public Law 93-383, 93rd Congress, August 22, 1974.

(b) any person because he is or has been, or in order to intimidate such person or any other person or any class of persons from—

(1) participating, without discrimination on account of race, color, religion, sex, or national origin, in any of the activities, services, organizations or facilities described in subsection 901(a); or

(2) affording another person or class of persons opportunity or protection so to participate; or

(c) any citizen because he is or has been, or in order to discourage such citizen or any other citizen from lawfully aiding or encouraging other persons to participate, without discrimination on account of race, color, religion, sex, or national origin, in any of the activities, services, organizations or facilities described in subsection 901(a), or participating lawfully in speech or peaceful assembly opposing any denial of the opportunity to so participate—

shall be fined not more than $1,000, or imprisoned not more than one year, or both; and if bodily injury results shall be fined not more than $10,000, or imprisoned not more than ten years, or both; and if death results shall be subject to imprisonment for any term of years or for life.

Penalty.

TITLE X—CIVIL OBEDIENCE

SHORT TITLE

SEC. 1001. This title may be cited as the "Civil Obedience Act of 1968".

"Civil Obedience Act of 1968."

CRIMINAL PENALITIES FOR ACTS COMMITTED IN CIVIL DISORDERS

SEC. 1002. (a) Title 18, United States Code, is amended by inserting after chapter 11 thereof the following new chapter:

76 Stat. 1119.
18 USC 201-224.

"Chapter 12.—CIVIL DISORDERS

"Sec.
"231. Civil disorders.
"232. Definitions.
"233. Preemption.

"§ 231. Civil disorders

"(a)(1) Whoever teaches or demonstrates to any other person the use, application, or making of any firearm or explosive or incendiary device, or technique capable of causing injury or death to persons, knowing or having reason to know or intending that the same will be unlawfully employed for use in, or in furtherance of, a civil disorder which may in any way or degree obstruct, delay, or adversely affect commerce or the movement of any article or commodity in commerce or the conduct or performance of any federally protected function; or

"(2) Whoever transports or manufactures for transportation in commerce any firearm, or explosive or incendiary device, knowing or having reason to know or intending that the same will be used unlawfully in furtherance of a civil disorder; or

"(3) Whoever commits or attempts to commit any act to obstruct, impede, or interfere with any fireman or law enforcement officer lawfully engaged in the lawful performance of his official duties incident to and during the commission of a civil disorder which in any way or degree obstructs, delays, or adversely affects commerce or the movement of any article or commodity in commerce or the conduct or performance of any federally protected function—

Penalty.

"Shall be fined not more than $10,000 or imprisoned not more than five years, or both.

"(b) Nothing contained in this section shall make unlawful any act of any law enforcement officer which is performed in the lawful performance of his official duties.

"§ 232. Definitions

"For purposes of this chapter:

"(1) The term 'civil disorder' means any public disturbance, involving acts of violence by assemblages of three or more persons, which causes an immediate danger of or results in damage or injury to the property or person of any other individual.

"(2) The term 'commerce' means commerce (A) between any State or the District of Columbia and any place outside thereof; (B) between points within any State or the District of Columbia, but through any place outside thereof; or (C) wholly within the District of Columbia.

"(3) The term 'federally protected function' means any function, operation, or action carried out, under the laws of the United States, by any department, agency, or instrumentality of the United States or by an officer or employee thereof; and such term shall specifically include, but not be limited to, the collection and distribution of the United States mails.

"(4) The term 'firearm' means any weapon which is designed to or may readily be converted to expel any projectile by the action of an explosive; or the frame or receiver of any such weapon.

"(5) The term 'explosive or incendiary device' means (A) dynamite and all other forms of high explosives, (B) any explosive bomb, grenade, missile, or similar device, and (C) any incendiary bomb or grenade, firebomb, or similar device, including any device which (i) consists of or includes a breakable container including a flammable liquid or compound, and a wick composed of any material which, when ignited, is capable of igniting such flammable liquid or compound, and (ii) can be carried or thrown by one individual acting alone.

"(6) The term 'fireman' means any member of a fire department (including a volunteer fire department) of any State, any political subdivision of a State, or the District of Columbia.

70A Stat. 4.

"(7) The term 'law enforcement officer' means any officer or employee of the United States, any State, any political subdivision of a State, or the District of Columbia, while engaged in the enforcement or prosecution of any of the criminal laws of the United States, a State, any political subdivision of a State, or the District of Columbia; and such term shall specifically include, but shall not be limited to, members of the National Guard, as defined in section 101(9) of title 10, United States Code, members of the organized militia of any State, or territory of the United States, the Commonwealth of Puerto Rico, or the

District of Columbia, not included within the definition of National Guard as defined by such section 101(9), and members of the Armed Forces of the United States, while engaged in suppressing acts of violence or restoring law and order during a civil disorder.

"§ 233. Preemption

"Nothing contained in this chapter shall be construed as indicating an intent on the part of Congress to occupy the field in which any provisions of the chapter operate to the exclusion of State or local laws on the same subject matter, nor shall any provision of this chapter be construed to invalidate any provision of State law unless such provision is inconsistent with any of the purposes of this chapter or any provision thereof."

(b) The table of contents to "PART I.—CRIMES" of title 18, United States Code, is amended by inserting after

62 Stat. 683.

"11. Bribery and graft ....211"

a new chapter reference as follows:

"12. Civil disorders ....213".

Approved April 11, 1968.

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APPENDIX 11

GENERAL INFORMATION ON SAMPLING

GENERAL:

A consumer examiner will use several types of sampling plans and selection techniques to determine compliance with consumer laws. It is possible during the course of the consumer compliance examination to use the following types of sampling plans:

1. Attribute sampling,
2. Discovery sampling, or
3. Judgment sampling.

It is also possible during the course of the consumer compliance examination to use the following types of selection techniques:

1. Interval,
2. Stratified, or
3. Cluster.

These sampling techniques are used because both the confidence level and precision of our results can be measured. For example, using discovery sampling and systematic interval selection, it is possible to say that you are 96% certain that the rate of compliance is 90%, +/- 2%.

Attribute Sampling:

Attribute sampling is used to provide an estimate of the number and/or amount of errors or characteristics in a population. For example, if a FCU failed to disclose the APR during a discovery sample, attribute sampling would be used to determine the number and amount of reimbursable violations in the loan portfolio based on a desired confidence level and rate of precision.

For example, by reviewing 473 out of 1,000 loans, you could determine the number and amount of reimbursements with a confidence level of 95.5% and a precision rate of plus or minus (+/-) 2%. Or, by reviewing 16 out of 1,000 loans, you could determine the number and amount of reimbursements with a confidence level of 50% and a precision rate of plus or minus (+/-) 5%.

Discovery Sampling:

Discovery sampling is used primarily to search for "critical errors" or in our case, compliance with a specific law or regulation. When an exception is critical, such as an exception to Regulation Z, Section 226.8(b)(2), any occurrence rate can not be tolerated. If no exceptions are found in discovery sampling, the consumer examiner may conclude that the critical error does not exist to the extent of the stipulated occurrence rate.

Although discovery sampling is designed to locate relatively rare exceptions, it cannot locate an insignificant exception (0.5% or less). However, discovery sampling can detect exceptions occurring at a rate as low as 0.5 to 1 percent with a very high degree of confidence.

For example, by reviewing 25 loans and not finding any exceptions, you could state that you are 93% confident that the exception rate is less than 10%. Or, by reviewing 10 loans and not finding any exceptions, you could state that you are 65% confident that the exception rate is less than 10%. These statistics apply regardless of the size of the population being sampled.

Judgment Sampling:

Judgment sampling is used to provide the consumer examiner with clues as to whether to proceed with a statistical sample. In addition, judgment sampling may be used to select examples of non-compliance to support the consumer examiner's contention that the loan portfolio is weak regarding compliance. Judgment sampling should not be used to estimate the number or amount of violations because each loan in the loan portfolio is not given an equal chance of selection. Judgment sampling is subjective, not objective.

Interval Selection:

Interval selection is another name used for a systematic random sampling procedure. A basic principle that must be respected in interval sampling is that each loan in the population must have an equal chance of being selected for inclusion in the sample. The major advantages of this sampling technique are:

1. Results are objective;
2. Results are defensible; and
3. Results can be measured and error of sample computed.

For example, assume a FCU granted 200 loans in the last 3 months. You would divide 200 by 25 loans to be reviewed and determine that your interval is 8. You would then pick a number between 1 and 8 for your first loan to review. Then you would take every 8th loan which would give you your sample of 25.

Stratified Selection:

Stratified selection means separating the population into two or more "strata", and then taking samples from each population. For example, during each consumer examination you will usually separate the population into two or more strata consisting of loans granted in the last three months, real estate loans, rejected applications, etc.

Once stratification is accomplished, the selection of the loans to be reviewed can be done through interval selection.

Cluster Selection:

Cluster selection is used when the loans to be reviewed are scattered or filed in some way that makes interval selection inadvisable. Cluster selection is what the name implies. For example, clusters of loans are selected at random. Then, the clusters are either reviewed in their entirety, or are themselves sampled. The latter method is referred to as multistage selection. So long as each selection is random - first the cluster and then, if necessary, the loans within the cluster - no rules are violated, since each loan has been afforded an equal chance of selection.

STATEMENT OF ENFORCEMENT POLICY IN RE TRADE REGULATION RULE ON PRESERVATION OF CONSUMER'S CLAIMS AND DEFENSES

On May 14, 1976, the Commission's Trade Regulation Rule concerning Preservation of Consumer's Claims and Defenses (16 C.F.R. 433) became effective. In adopting the Rule, the Commission determined that it constitutes an unfair and deceptive practice within the meaning of Section Five of the Federal Trade Commission Act (15 U.S.C. 45), for a seller in the course of financing or arranging the financing of a purchase of consumer goods or services to employ procedures which render the consumer's duty to pay independent of the seller's duty to fulfill his obligations. The Rule requires the insertion of a clause in consumer credit contracts which permits the consumer to raise against the creditor those claims and defenses that he could raise against the seller under applicable law. The Rule does not give the consumer the right to withhold payment unilaterally. "The manner and procedure by which a buyer may assert claims and defenses is governed by the terms of any contractual obligation and by applicable state law."

Since the effective date of the Rule, the Commission has received a number of requests for a further clarification of its applicability to transactions in which a seller accepts the proceeds of a loan extended directly from a lender to a purchaser. This Statement of Enforcement Policy explains the Rule's definition of "purchase money loan" which encompasses certain loans of this nature. It is a restatement of the Commission's intent in this regard based on the language of the Rule and the Statement of Basis and Purpose.

This Statement is issued as a guide for compliance with the Rule. It is also intended as an aid to assure consistent application of the Rule under those state laws which create additional private remedies for violation of its requirements.

I. Introduction

The Rule requires that the prescribed notice be included in a loan document when the seller accepts the proceeds of a "purchase money loan" extended by the creditor directly to the purchaser. The definition of a "purchase money loan" limits the Rule's applicability to direct loans where the seller "refers" customers to the creditor or is "affiliated" with the creditor.[1]

The statement of Basis and Purpose issued with the Rule specifies the nature of the business relationships that are encompassed by this standard.

> [C]onsumer credit obligations should be subject to claims and defenses whenever credit is arranged or secured in connection with a continuing relationship between a seller and a creditor. In such cases a seller and creditor may properly be viewed as joint ventures. The basic rationale for the rule . . . applies in any situation where sellers and creditors work cooperatively to finance consumer sales.[2]

The affiliation and referral standards are intended to delineate those business relationships where sellers and creditors engage in concerted or cooperative conduct to arrange credit for consumers. The terms are not intended to be wholly separate concepts and are to some extent coextensive in their impact. They are employed in this manner to assure that the broad spectrum of business relationships which reflect such joint activity are brought within the Rule.

The affiliation test applies where the lender and seller are part of the same business entity, or where there is a preexisting formal or informal contractual agreement or business arrangement to engage in concerted activity in connection with the financing of consumer goods and services. The referral test does not contemplate a preexisting agreement of this type. It encompasses relationships in which the lender and seller cooperate to channel purchases on a continuing basis. Such a course of conduct results in a defacto or implied relationship. If the seller is sending buyers to a creditor without the express or implied agreement of the creditor or without any concerted or cooperative activity between the seller and the creditor in connection with the financing of consumer sales, the transaction is not within the Rule. It is important to note that such agreement or concerted or cooperative activity must relate to the actual financing of the sale and not to ancillary conduct such as perfecting a security interest.

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[1] C.F.R. 433.1(d).

[2] Statement of Basis and Purpose, 40 Federal Register 53521 November 18, 1975.

a) *Affiliation*

The Rule requires a seller to insure that the Notice is used in a consumer's loan contract where the seller is "affiliated with the creditor by common control, contract, or business arrangement."[3]

The first type of affiliation is common control. The Commission has concluded that when a creditor and a seller are functionally part of the same business entity, loans made by the lender for the financing of purchases from the seller should be subject to the Rule. For example, common control would be present where two companies are owned by a holding company or by substantially the same individuals; if one is a subsidiary of the other, or if they are under common control relating to retail sales financing.

An affiliation is also created by "contract" and "business arrangement." The Rule defines contract as any oral or written agreement, formal or informal between a creditor and a seller, which contemplates or provides for cooperative or concerted activity in connection with the sale of goods or services to consumers or the financing thereof. A business arrangement includes any understanding, procedure, course of dealing, or arrangement, formal or informal, between a creditor and a seller, in connection with the sale of goods or services to consumers or the financing thereof.

These definitions encompass all situations where a creditor and seller are party to any agreement, arrangement, understanding, or mutually understood procedure which is specifically related to retail sales or retail sales financing. While the business arrangement or contract need not be formal in a legal sense, it must be ongoing and clearly related to sales or sales financing.

Examples of the business arrangements or contracts which are reached by the Rule's definitions would include those contemplating:

—Maintenance of loan application forms in the office of the seller;

—Seller agrees with creditor to prepare loan documents;

—Creditor's referrals of customers to a sales outlet;

Payment of consideration to a seller for furnishing loan customers or to a creditor for furnishing sales prospects;

—The assignment of indirect paper or the referral of loan customers to a creditor;

—Active creditor participation in a sales program;

—Joint advertising efforts;

—An agreement to purchase paper on an indirect basis.

The Rule is not intended to include the many possible business relationships that do not bear directly on the financing of consumer sales. For example, a commercial checking account is not an affiliation within the meaning of the Rule, nor is a commercial credit agreement between the seller and a credit institution which has no relationship to consumer sales activities or the financing thereof. A commercial lease, the factoring of accounts receivable, a general business loan, the financing of inventory, or other similar commercial arrangements or contracts do not invoke the Rule. The installation in a seller's place of business of a system for approval of personal checks is not a business arrangement within the meaning of the Rule. It should also be noted that an agreement between a credit card issuer and a seller does not constitute a business arrangement or a contract within the meaning of the Rule.

The fact that a creditor and seller must confer over a particular transaction does not in itself create an arrangement. Thus, for example, the mere fact that a creditor issues a joint proceeds check to a seller and a buyer or that seller and lender must confer in order to perfect the security agreement under applicable state law is not a business arrangement or contract.[4]

b) *Referrals*

The Rule prohibits a seller from accepting the proceeds of a "purchase money loan" unless the credit contract contains the required Notice when the seller "refers consumers to the creditor." The intent of this provision is to reach those situations in which a seller cooperates with a lender to channel consumers to that credit source on a continuing basis. Unlike an "affiliation," which contemplates some pre-existing arrangement or agreement, a referral relationship arises from a pattern of cooperative activity directly relating to the arranging of credit.

Several elements are necessary. The seller and creditor must be engaged in cooperative or concerted conduct to channel a consumer to a particular lender. The fact that a seller may suggest credit sources to his customers or otherwise provide information in this regard does not alone invoke the Rule. However, when a seller and lender work together to arrange financing for seller's customers the prescribed notice must be incorporated in the loan contract.

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[3] 16 C.F.R. 433.1(d)(2).

[4] See, Federal Trade Commission Advisory Opinion #75-7007 to National Automobile Dealers Association, May, 1976.

This conduct must occur on a continuing basis. Occasional referrals which are not part of a business routine of the seller does not trigger the Rule. Once a referral relationship is established all credit contracts between that lender and buyers who spend the proceeds at the seller's establishment must contain the Notice.

Finally, it should be emphasized that formal consideration need not pass between the seller and lender. The fact that a seller and lender are cooperatively engaged in an effort which is mutually beneficial to their separate business interests is sufficient.

c) *Application of the referral and affiliation standards*

The following examples illustrate how the referral and affiliation standards are applied.

1. A seller has an agreement with a creditor to maintain loan application forms in the seller's office. When a buyer requests financing, the seller assists the buyer in filling out the forms. This relationship constitutes an affiliation and the Notice must be included in the consumer credit contract.

2. A seller regularly sends his customers to a particular creditor. The creditor, in turn, agrees to provide a favorable financing arrangement for the seller's inventory or directly or indirectly provides some other consideration. The seller and lender are "affiliated." The Notice must be included in the consumer credit contract.

Comment: These circumstances would give rise to a "contract" as defined by §433.1(f).

3. A seller regularly sends his customer to a particular creditor. The creditor agrees that as long as the seller continues to refer his customers, their loan applications will be processed or approved on an expedited basis where the borrower meets certain lending criteria but before a full credit check is completed. The notice must be in.

Comment: An Agreement of this nature would constitute a business arrangement. (Typically in situations such as those in the example, the seller would agree to repurchase any contracts which the lender ultimately did not accept. However, a repurchase agreement of this nature is not essential to bring the above conduct within the Rule.)

4. A seller routinely suggests that customers in need of credit go to a particular source or sources of financing. While the creditor is aware that seller is sending some of his customers, the creditor does not provide any tacit or explicit quid pro quo, and seller and financer have no relationship that would constitute an affiliation and do not otherwise cooperate except insofar as may be necessary to arrange payment, perfect a security interest or otherwise finalize the transaction. The Notice is not required.

Comment: The Rule draws the line between situations in which the seller is acting as an information source of where credit is available and those in which the seller is arranging credit or serving as a conduit for the creditor. For a referral to occur within the meaning of the Rule, there must be something more than a simple suggestion that credit might be available from a particular source. There must be some further affirmative act by the seller to promote the consummation of the loan.

Since a simple suggestion is not a referral, it does not matter how often it is repeated.

This interpretation also answers a question raised by some creditors as to the result if a seller sends customers to them and they do not know the customers are being sent. Such lack of knowledge on the part of the creditor automatically precludes the possibility that a referral has taken place.

5. A buyer asks a seller for credit information. The seller suggests a creditor, calls up the creditor to determine whether the creditor will lend money to the particular buyer, and then sends the buyer to the creditor. Seller and creditor have no agreement, formal or informal, to refer customers. A referral relationship would be created, if the channeling occurs on a continuing basis.

Comment: When a seller contacts a lender and arranges credit for his customers on a continuing basis, there is suggicient cooperative activity to constitute a referral relationship. Monetary or other formal consideration need not be involved. A pattern of mutual accommodation in arranging loans is sufficient concerted or cooperative activity to establish a referral relationship. However, contact between the seller and creditor which first occurs after the loan has been secured, for purposes of securing a lien or approving a bank draft is not a referral since there is no cooperative activity in the arranging of credit.

6. A buyer asks a seller for credit sources. Seller provides a list of lenders in the area and provides information on the availability of credit from them as an accommodation to his customers. The seller does not contact a creditor to arrange credit for the customers, nor does he have any other business arrangement or affiliation with the creditors in this respect. The Notice is not required.

Comment: When the seller is merely providing buyer with information on the choices available to the buyer, does not channel the buyer by contacting the creditor, and has no agreement to mention a particular creditor, then the buyer is providing information and the Notice is not required.

7. A seller has a referral or affiliation relationship with a creditor. A buyer, on his own, goes to the creditor to obtain a loan to purchase sn item from seller. The Notice must be in.

Comment: If a seller has an arrangement whereby he refers his customers to a creditor, all loan contracts between that creditor and a borrower who uses the proceeds to purchase goods from that seller must contain the Notice. The Notice must be in whether the particular loan contract was the product of a referral or not.

8. Seller has for years referred his customers to a particular financial institution pursuant to an arrangement with the creditor. He now desires to end the relationship. He stops the referrals and notifies the creditor that he no longer will refer buyers. The referral relationship has been terminated.

Comment: A referral relationship is a continuing one. It can be stopped as long as the termination is genuine, and the seller is not attempting to temporarily avoid the Rule for a few transactions. The creditor can also end a referral relationship by notifying seller that he does not wish the relationship to continue and by refusing to place the Notice in his loan contracts with purchasers from that seller.

II. Determining the Source of the Proceeds

The seller is prohibited from accepting the proceeds of a "purchase money loan" unless the consumer credit contract contains the specified Notice. Since the credit contract is between the borrower and the lender, the seller may not be aware that tha money he is receiving is the proceeds of a "purchase money loan." The problem arises when the seller and the creditor are affiliated by common control, contract, or business arrangement or are engaged in a referral relationship and the buyer has unilaterally gone to the creditor for a loan to purchase goods or services from the seller.

The Rule was not intended to subject a seller to liability when he has no reason to believe he is receiving the proceeds of a "purchase money loan." Nor does the Rule require that the seller interrogate the buyer to determine the source of the proceeds. The objective circumstances surrounding the transaction provide the seller with information concerning the source of the proceeds. When these circumstances do not indicate the source of the proceeds or do not provide reason to believe that the proceeds may be from a "purchase money loan," there is no obligation to further investigate the source of the proceeds.

1. A buyer arrives in the seller's showroom with a joint proceeds check or a bank draft drawn on a bank affiliated with the seller. The seller is on notice to inquire as to whether the Notice was included.

Comment: A joint proceeds check provides actual knowledge that a purchase money loan is involved. A bank draft places a seller on notice that the instrument is probably the proceeds of a purchase money loan.

2. A buyer pays for a seller's product or service with cash or a personal check. There is no duty to inquire.

Comment: When there are no facts that would place a reasonable man on notice that the money is the proceeds of a "purchase money loan," there is no obligation to interrogate a customer.

3. A buyer pays $5,000 for an automobile with a personal check drawn on the bank that purchases the seller's contracts. The buyer states that he obtained a signature loan from that bank to pay for it. Seller must determine if the Notice was inserted.

4. Seller determines that the money the buyer uses to purchase a product are the proceeds of a "purchase money loan." The Seller asks the buyer whether the Notice has been included in the consumer credit contract. The buyer refuses to answer or incorrectly states the Notice was included. The seller must communicate with the creditor.

Comment: When the seller has a relationship with a creditor, the best source of information concerning the Notice is the creditor. He cannot escape liability through the ignorance of the buyer.

CREDIT UNION ADMINISTRATION

INTERPRETIVE RULING AND POLICY STATEMENT

IRPS No. 80-10 **DATE:** October 23,1980

NATIONAL CREDIT UNION ADMINISTRATION

12 C.F.R. 701.21-5

IRPS 80-10

STATEMENT OF INTERPRETATION AND POLICY:

When Federal Credit Unions Can Charge More Than 15 Percent Per Annum on Government Insured or Guaranteed Loans

AGENCY: National Credit Union Administration

ACTION: Statement of Interpretation and Policy

SUMMARY: This document states that on a government insured or guaranteed loan, a Federal credit union may charge an interest rate in excess of 15 percent per annum on the unpaid balance inclusive of all finance charges if a higher rate is either expressly required or expressly permitted by the laws and regulations governing the insured or guaranteed loan program. This interpretation and policy statement is needed because certain government agencies have recently raised the permissible interest rates on insured or guaranteed loans to rates in excess of 15 percent per annum on the unpaid balance inclusive of all finance charges.

EFFECTIVE DATE: October 17, 1980.

ADDRESS: National Credit Union Administration, 1776 G Street, N.W., Washington, D.C. 20456.

FOR FURTHER INFORMATION CONTACT: John L. Culhane, Jr., Attorney Advisor, Office of General Counsel, or Thomas C. Buckman, Staff Accountant (Analyst), Office of Examination and Insurance. Telephone Numbers: (202) 357-1030 (Mr. Culhane), (202) 357-1065 (Mr. Buckman).

SUPPLEMENTARY INFORMATION:

Recently, certain government agencies have raised the permissible interest rates on insured or guaranteed loans to rates in excess of 15 per cent per annum on the unpaid balance inclusive of all finance charges. The Department of Housing and Urban Development has raised the maximum finance charge on insured mobile home loans from 15.00 percent to 15.50 percent. HUD has also raised the maximum charge on insured property improvement loans from 15.00 percent to 15.50 percent. 45 F.R. 63838 (1980). In addition, the Veterans Administration has raised the maximum rate on energy loans to 15 1/2 percent per annum on the unpaid principal balance. 45 F.R. 63841 (1980). As a result, the question has been raised whether the Federal Credit Union Act and NCUA's regulations permit Federal credit unions to charge interest rates in excess of 15 per centum per annum on government insured or guaranteed loans.

Section 107(5)(A)(vi) of the Federal Credit union Act provides that the rate of interest on Federal credit union loans may not normally exceed 15 per centum per annum on the unpaid balance inclusive of all finance charges. 12 U.S.C 1757(5)(A)(vi). However, a special statutory provision applies in the case of government insured or guaranteed loans. Section 107(5)(A)(iii) of the Federal Credit Union Act states that "a loan secured by the insurance or guarantee of the Federal Government, of a State Government, or any agency of either may be made for the maturity and under the terms and conditions specified in the law under which such insurance or guarantee is provided." 12 U.S.C. 1757(5)(A)(iii). Section 701.21-5 of NCUA's regulations interprets this statutory provision to mean that "a Federal credit union which has been qualified as a lender under a Federal or State insured or guaranteed loan program may make loans to members under the terms and conditions and within the maturities specified by the laws and regulations governing the program." 12 C.F.R. 701.21-5(a).

The National Credit Union Administration concludes that the phrase "terms and conditions" was meant to include the interest rate on loans and that "specified" was meant to cover situations where a term and condition is either expressly required or expressly permitted. Consequently, this interpretive ruling and policy statement has been approved to clarify that a Federal credit union can charge an interest rate in excess of 15 percent per annum on the unpaid balance inclusive of all finance charges on government insured or guaranteed loans, if a higher rate is either expressly required or expressly permitted by the laws and regulations governing the insured or guaranteed loan program. In making this decision, NCUA notes that guarantees and insurance are used by government agencies to encourage lending for certain social or economic objectives. NCUA believes that Congress did not intend for Federal credit unions to be precluded from participating in government insured or guaranteed loan programs simply because of rising interest rates.

Text of Statement of Interpretation and Policy (IRPS 80-10):

Section 107(5)(A)(iii) of the Federal Credit Union act states that "a loan secured by the insurance or guarantee of the Federal Government, of a State Government, or any agency of either may be made for the maturity and under the terms and conditions specified in the law under which such insurance or guarantee is provided." Section 701.21-5(a) of NCUA's regulations states that "A Federal credit union which has been qualified as a lender under a Federal or State insured or guaranteed loan program may make loans to members under the terms and conditions and within the maturities specified by the laws and regulations governing the program."

NCUA interprets the phrase "terms and conditions" to include the interest rate on the loan. NCUA also interprets "specified" to mean that the term and condition is either expressly required or is expressly permitted by the laws and regulations governing the program. Consequently, a Federal credit union may charge an interest rate in excess of 15 percent per annum on the unpaid balance inclusive of all finance charges on a government insured or guaranteed loan if the higher rate is either expressly required or expressly permitted by the laws and regulations governing the program.

/s/
ROSEMARY BRADY
Secretary, NCUA Board

October 23, 1980

NATIONAL CREDIT UNION ADMINISTRATION
WASHINGTON, D.C. 20456

April ., 1980

TO ALL FEDERAL CREDIT UNIONS ADDRESSED:

On Monday, March 31, 1980, President Carter signed the Depository Institutions Deregulation and Monetary Control Act of 1980. As part of that legislation, the Federal Credit Union Act was amended by changing the loan interest rate ceiling from "1% per month (12% per year) on the unpaid balance inclusive of all service charges" to "15% per year on the unpaid balance inclusive of all finance charges." In addition, the National Credit Union Administration Board now has the authority to raise the ceiling above 15% for periods of time up to 18 months.

Effective March 31, 1980, the NCUA Board amended Part 701 of the NCUA Rules and Regulations to reflect the procedures necessary to raise loan interest rates above 12%. Please note that once a Federal credit union's board of directors increases the rate of interest for any one loan class above 12%, the notice required by the final regulation must be provided. The notice requirement is the only new requirement imposed by this rule. Advance notice is not required by NCUA.

The Board has determined that the term "finance charges", as it now appears in Section 107(5)(A)(vi) of the Federal Credit Union Act, should track as closely as possible the computation of the finance charge as set forth in Section 106 of the Truth in Lending Act. Consequently, those charges included (and excluded) from the finance charge determination under the Truth in Lending Act and Regulation Z are finance charges (or not finance charges) for purposes of the requirement in the Federal Credit Union Act that loans to members shall not exceed 15% per year inclusive of all finance charges. The Board will most likely issue an interpretative ruling covering finance charges in the near future.

Finally, with respect to open end credit, Federal credit union's should be keenly aware that any increase in the interest rate on open end loan plans is subject to applicable state laws, including any notification requirements. Thus, for example, both the open end agreement and any applicable state law will determine whether the increased interest rate can apply to existing open end balances. Interest rate increases must also comply with any other Federal laws, such as the Truth in Lending Act. In this regard, note that Section 226.7(f) of Regulation Z requires that written notice of an increase in the periodic rate on an open end loan account must be given to the account holder at least 15 days prior to the beginning date of the billing cycle in which the increased rate is imposed. Federal credit unions that issue quarterly statements for open end accounts must therefore provide the notice at least 15 days prior to the beginning of the next quarter (if the rate is to be effective in that quarter).

Concerning existing closed end loans, the interest rate cannot be increased unless such action is provided for in the loan contract. On any such loan contract, Federal credit union's are cautioned to ensure that proper disclosures under Section 226.8 of Regulation Z were given.

The amendments adopted by the Board are as follows:

1. 12 C.F.R. 701.21-1(c), 701.21-1(d) and 701.21-1(e) are redesignated as 12 C.F.R. 701.21-1(d), 701.21-1(e) and 701.21-1(f), respectively;
2. The words "subsection (c), below", in Section 710.21-1(b) are revised to read "paragraph (d) of this section".
3. The words "paragraph (d)" in redesignated §701.21-1(f) are revised to read "paragraph (e)";
4. Section 701 [illegible] amended by adding a new paragraph (c), to read as follows:

(c) On the first ocassion on which the board of directors of a Federal credit union determines to charge a loan interest rate in excess of 12% per year on the unpaid balance inclusive of all finance charges, the Federal credit union shall provide notification to its members which shall:

(1) state the reasons for and the effective date of the increase;

(2) adequately inform the members of the credit union of the maximum loan interest rate authorized by law. The notification may state, "Your credit union is authorized by law to charge a maximum loan interest rate of 15% per year on the unpaid balance inclusive of all

finance charges, or such amount in excess of 15% as may be authorized by the National Credit Union Administration Board"; and

(3) be effected by:

(A) immediately posting a conspicuous written notice in the main office and all branch offices of the Federal credit union; and

(B) providing actual notice by mail or otherwise, at the earliest opportunity, to all members receiving the credit union's most recent statement of account, if the board of directors determines that the posting of the notification is not sufficient to provide actual notice to a majority of the Federal credit union's members.

5. 12 C.F.R. 701.21-3(b)(3) is amended by deleting the term "1 per centum per month on the unpaid balance inclusive of all service charges" and inserting in lieu thereof the term "15% per year on the unpaid balance inclusive of all finance charges";

6. 12 C.F.R. 701.21-6(a)(14) and 12 C.F.R. 701.21-6(c)(4) are repealed;

7. 12 C.F.R. 701.21-6(c)(5) and 12 C.F.R. 701.21-6(c)(6) are redesignated as 12 C.F.R. 701.21-6(c)(4) and 12 C.F.R. 701.21-6(c)(5) respectively;

8. Redesignated 12 C.F.R. 701.21-6(c)(4) is amended by: deleting in the first sentence the term "service charges" and inserting in lieu thereof the term "finance charges"; deleting in the second sentence the term "1 per centum per month" and inserting in lieu thereof "15 per cent per year".

LAWRENCE CONNELL, Jr.
Chairman

PENDIX 13

NATIONAL CREDIT UNION ADMINISTRATION

INTERPRETIVE RULING AND POLICY STATEMENT

DATE: December 12, 1979

NATIONAL CREDIT UNION ADMINISTRATION

12 C.F.R. Chapter VII

Interpretive Ruling - Rate of Interest

AGENCY: National Credit Union Administration

ACTION: Interpretation of General Applicability

SUMMARY: This statement sets forth the National Credit Union Administration's interpretation of the effect a compensating balance has upon the rate of interest on Federal credit union (FCU) loans for purposes of Section 107(5)(A)(vi) of the Federal Credit Union Act. Under this interpretation, a compensating balance required on an FCU loan must be considered in determining the rate of interest on the loan. Pursuant to Section 107, the resulting rate of interest may not exceed 1% per month (12% per year).

EFFECTIVE DATE: Immediately upon publication.

ADDRESS: National Credit Union Administration, 1776 G Street, N.W., Washington, D.C. 20456

FOR FURTHER INFORMATION CONTACT: Robert M. Fenner, Assistant General Counsel, or Edward J. Dobranski, Senior Attorney, both of the Office of General Counsel, National Credit Union Administration, at the above address. Phone: (202) 357-1030.

Interpretation
[IRPS No. 79-9]

This interpretation states that the effect of a compensating balance must be considered in order to determine the rate of interest on a Federal credit union (FCU) loan to a member for purposes of Section 107(5)(A)(vi) of the Federal Credit Union Act (12 U.S.C. 1757(5)(A)(vi)). That section states that the rate of interest on a loan to a member shall not exceed 1% per month (12% per year) on the unpaid balance inclusive of all service charges.

I. DEFINITION OF COMPENSATING BALANCE

1. The term 'compensating balance' means a deposit in a Federal credit union (FCU):

> (a) that the FCU requires that the member/borrower make;1/
>
> (b) that is created fro+%Q!er (i) part or all of the proceeds of the loan or (ii) from any outside source (including the borrower's own funds); and
>
> (c) that is not accessible to the member/borrower for a given period of time.

2. The term does not include any deposit in the FCU that the member/borrower has made previously without regard to any loan requirement or lending policy that such a deposit be made, and the amount of which is given as security for the loan.

An explanation of the terms used in the definition is set forth below.

The term 'deposit' refers to a share account of any type, or a share certificate account,2/ or a certificate of indebtedness. It does not include the $5 share membership requirement, for that requirement exists independently of any loan (even if given concurrently with a loan) and is mandated by Section 109 of the Federal Credit Union Act (12 U.S.C. 1759).

1/ Systematic loan/savings plans do not fall within the scope of this interpretive ruling. The issue of whether such plans must be considered for purposes of 12 U.S.C. 1757(5)(A)(vi) will be addressed in a subsequent interpretive ruling.

2/ Thus, if a share certificate is required to be purchased as a condition of a loan, and it is required to be given as security on the loan, then a compensating balance arises.

The term 'requires that the member/borrower make' means that funds must be placed in the FCU in order to obtain a particular loan. It is important to note that this requirement can arise in a number of ways; for example, on the face of the loan agreement (such as a security requirement or a requirement of deposit [with or without security]); as an FCU lending policy (e.g., that to qualify for a loan the member/borrower must have 20% of the loan amount in shares); or a requirement that is conveyed orally to a particular borrower (e.g., by the loan officer).

The term 'created from the loan proceeds' is essentially self explanatory, i.e., part of the loan is kept in an account in the FCU.3/

The term 'created from any outside source (including the borrower's own funds)' covers the situation where the borrower receives the entire amount contracted for in the loan agreement, but is required to place a certain amount of funds (from any source) in the FCU, and such funds may not be withdrawn for a given time period.

The term 'not accessible to the member/borrower' means funds to which a borrower does not have an automatic, unfettered right of withdrawal.4/ Thus, e.g., funds that are placed with the FCU as a requirement of the loan, and that are subject to withdrawal only with credit committee approval pursuant to a separate requirement in the loan agreement or pursuant to a security interest in those shares, would be considered not accessible for purposes of this interpretation.

The term 'compensating balance' as used herein does not include any funds that were previously and independently placed into a share account (without regard to any lending policy or loan requirement) and that are subsequently offered as security for the loan. Such funds do not affect the 1% per month interest rate limitation. For example, suppose an FCU requires 20% of the loan balance to be maintained in shares in order to qualify for a loan. If a member wishes to borrow $5,000, in order to be eligible to borrow such an amount, $1,000 must be in shares (with such $1,000 being inaccessible for a certain period of time). If the member already had $1,000 in shares (and no portion of the $1,000 was placed in shares for the purpose of meeting the FCU 20% requirement for a contemplated loan), and if the shares are given as security on the loan, no compensating balance arises, even though the funds are inaccessible until

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3/ Note that estate loans (where the borrower requests that all proceeds of the loan be placed into shares, and which are inaccessible), will be addressed in a subsequent interpretive ruling.

4/ Pursuant to the same rationale applicable to the $5 share membership requirement, the imposition by the FCU of the 60 day notice of withdrawal requirement on all accounts, as provided for in Article III, Section 5(a) of the Federal Credit Union Bylaws, does not render shares inaccessible for purposes of this ruling.

the loan balance is less than the share amount. However, if the member had only $600 in shares, and put $400 from his or her own pocket into the share account in order to qualify for the loan (or agreed to place $400 from the loan proceeds into shares), then a $400 compensating balance exists and that compensating balance must be considered in determining the rate of interest for purposes of Section 107(5)(A)(vi) of the Federal Credit Union Act.

II. LEGAL RATIONALE

As stated above, the pertinent provision of the Federal Credit Union Act is Section 107(5)(A)(vi) (12 U.S.C. 1757(5)(A)(vi)), which provides that the rate of interest on an FCU loan shall not exceed 1% per month (12% per year) on the unpaid balance inclusive of all service charges. The issue which has arisen concerning the relationship between Section 107 and compensating balances is best illustrated through an example. If a loan of $1,000 is contracted for, with monthly payments, and if the FCU requires that $200 of such loan be placed in the borrower's share account (to be inaccessible for a given period of time), upon what amount may the FCU charge 12% per year (i.e., what is the unpaid balance)?5/

It is NCUA's position that 12% per year may not be assessed upon the entire amount of the loan ($1,000 in the example). This position is predicated upon recognition of the time value of money and upon the resolution of this issue reached by a vast majority of those courts that have addressed it.

The term 'interest', by definition, mandates consideration of the funds a borrower has use of and of the time the borrower has use of such funds.6/ Interest is thus the value of funds available for one's use. That value varies depending upon how long the funds may be used, i.e., the time value of money. When funds 'borrowed' may not be used for a period of time, the value of those funds decreases. The resulting value is termed 'present value'. Thus, for example, given a loan of $1,000 with a $200

5/ Stated another way, what is the maximum monthly interest rate factor that may be applied to the full $1,000? It is understood that FCU's will of necessity perceive the computation as a determination of the periodic interest rate factor and treat the loan as one for $1,000. The discussion in the text is used simply to more clearly explain the issue.

6/ 'Interest' is universally defined as compensation received by a lender for the use of money. See, e.g., 47 C.J.S. Interest §1 and 45 Am. Jur. 2d Interest §1, for a listing of a number of cases that have recognized this definition. Interest can also be viewed as compensation for the creditor's loss of the use of funds. Thus, when a compensating balance is required for a given time period, the creditor is not deprived of the use of funds for such time.

compensating balance, 1% per month may be assessed only upon the sum of $800 plus the present value of the $200 compensating balance. (That is, the FCU will be permitted to charge 1% per month [12% per year] on an amount somewhere between $800 and $1,000, depending upon the present value of the $200). The present value will vary depending upon how long the $200 is inaccessible. The longer the period of inaccessibility, the less its present value. In the alternative, the unpaid balance can be carried on the FCU's books as $1,000 in the example. In that situation, the monthly interest rate factor assessed upon that $1,000 cannot be 1%, because of the time value of money, and thus must necessarily be less that 1% (how much so again depends upon how long the $200 is inaccessible).7/

The concept of the time value of money, and why it must be considered when determining the relationship between a compensating balance and section 107, is clearly evident when a compensating balance type loan is compared to a multiple advance loan. Given a loan for $1,000 for one year, if the FCU states that it will advance $250 to the borrower at once, $250 after one month, and $500 after six months, it is clear that if the FCU charges 1% per month on $1,000 from the date of the first advance, the rate of interest is greater than 1% per month on the unpaid balance. Such a scheme would generate a greater rate of interest to the FCU than if the transaction was viewed as three separate loans, with 1% being charged on $250 for one year, 1% on $250 for 11 months, and 1% on $500 for six months. The crucial aspect in this type of determination is the time value of money (i.e., the funds the borrower has use of). A compensating balance is similar. If the FCU withholds part of the loan until a later date, ($200 in the example), the maximum interest rate may not be assessed upon that $200 if the borrower does not have immediate use of it.8/ Of course, time value methods of computation exist so that present value and the resulting rate of interest may be determined at the inception of a compensating balance loan. This rate may not exceed 12% per year.

As noted previously, a number of courts have addressed the issue of whether a compensating balance must be considered in determining the rate of interest on a loan, and the vast majority have concluded that such a consideration is necessary.9/ It is important to note that the cases referred to dealt with state law usury provisions. In short, many of the

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7/ As noted in footnote 5, since the FCU will choose to consider the unpaid balance to be the full amount of the loan, the monthly interest rate factor must be arrived at by considering the elements of use and time (i.e. the time value of money).

8/ Given the concept of the use of money, it makes no difference whether the compensating balance is created from the loan proceeds or from the borrower's own funds.

9/ For a general overview of case law addressing the question of whether usury results when a creditor requires a deposit of a debtor's funds, see 92 ALR 3d 769.

courts determined not only whether an excessive rate was actually reserved or received, but also determined whether the lender intended to reserve or receive such an excessive rate. This dual determination was necessary in those cases for each involved a provision imposing a penalty for charging an excessive rate of interest. The cases thus dealt with allegations of usury, i.e., excessive interest rates and allegations that such rates were charged by a lender with usurious intent, the latter being necessary to invoke the penalty provisions.

Unlike the court decisions, this interpretation does not address an entire usury provision. The usury provision of the Federal Credit Union Act is composed of two sections, §107(5)(A)(vi) and §107(5)(A)(vii). The former sets forth the maximum interest rate (1% per month); the latter, the penalty a borrower may invoke in court for a knowing violation of that limit. This interpretation necessarily encompasses only §107(5)(A)(vi) for it is solely that section of the usury provision for which NCUA is charged with regulatory responsibility. That responsibility extends only to interpreting what is necessary to determine the 'rate of interest on the unpaid balance'. It does not extend to making a determination of whether any particular action is usurious, i.e., taken with knowledge that an excessive rate was reserved or received (or cloaked with an intent that evidences such knowledge) so that the penalty provision of §107(5)(A)(vii) would be invoked. That type of determination is for a court, in an action brought by a borrower under §107(5)(A)(vii) (12 U.S.C. 1757(5)(A)(vii)).[10/]

Again, the courts, although making the dual determination noted, have overwhelmingly concluded that the imposition of the maximum interest rate on the amount contracted for, without consideration of the loss of use of money for a period of time which results from the imposition of a compensating balance, constitutes the charging of an excessive rate of interest.

Given such judicial precedent, and given present day concepts of the time value of money, NCUA interprets Section 107(5)(A)(vi) of the Federal Credit Union Act as requiring that compensating balances and their resulting loss of use of money must be considered when determining the rate of interest on the unpaid balance. This does not mean, of course, that compensating balances are illegal. It does mean, however, that a violation of Section 107(5)(A)(vi) occurs if, given consideration of any compensating balance, the rate of interest exceeds 1% per month (12% per year) on the unpaid balance inclusive of all service charges.

[10/] We recognize, of course, that an agency pronouncement such as this could very well be perceived by a court, in an action by a borrower under §107(5)(A)(vii) against an FCU, as imparting knowledge to an FCU for purposes of that section. That resolution, however, is for the judiciary, not NCUA, and will necessarily turn upon the facts in each particular case.

III. COMPUTATION

As noted previously, accepted methods of computation for determining the effects of a compensating balance may be employed.11/ Such methods determine how the compensating balance affects the rate of interest through consideration of the length of time the funds are inaccessible to the borrower and the amount of such funds. The computation for this determination must be done pursuant to such accepted methods of determining present value (i.e., determining the present value of funds that are inaccessible for a given period of time). Once the present value of the compensating balance is determined, the unpaid balance can be computed. Or, in the alternative, the FCU can compute the maximum periodic rate factor which may be applied so that the rate of interest does not exceed 1% per month (12% per year). Although NCUA will advise any FCU that intends to impose a compensating balance of the methods of calculation, it should be noted that any FCU that does impose a compensating balance will bear the burden of demonstrating that the rate of interest does not exceed 1% per month (12% per year) on the unpaid balance. In this regard, FCU's should note that since the computations are somewhat difficult, they should ensure that they can accurately perform them. This is especially important given §107(5)(A)(vii), the penalty provision.

Two other aspects of the computation deserve note. First, any dividends paid on a compensating balance may be considered in determining the rate of interest. Thus, the greater the dividends paid on the compensating balance, the lower the rate of interest.12/ Consideration of dividends is not mandatory (since dividends serve to lower the rate of interest), however, they may be considered by any FCU that can compute their effect.

Second, since an FCU by law13/ may not freeze shares in excess of any loan balance, portions of the compensating balance must be made available whenever the compensating balance exceeds the outstanding loan balance. If this happens, the staggered accessibility of funds can be considered in calculating the interest rate, if the FCU so chooses (and if it has the capability of performing the requisite mathematical computations). However, in making its calculations to determine the effect of the

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11/ For example, Supplement I to the Federal Reserve Board's Regulation Z sets out such a method. Note, however, that that method encompasses the actuarial computation of interest, not the U.S. Rule computation. Supplement I can be adapted to fit the U.S. Rule method however. .

12/ Although FCU's do not know in advance what the dividend rate will be (nor can they guarantee a rate), legally no objection exists to the use of a good faith estimate based upon past dividend rates or reasonable projections.

13/ Article III, Section 5(c) of the Federal Credit Union Bylaws.

compensating balance, the FCU may also choose to simply treat the compensating balance as though it is not accessible for the life of the loan.

IV. SCOPE

NCUA recognizes that this interpretation raises a host of other questions concerning a myriad of situations that do not fall within the definition of the term 'compensating balance' as set forth herein. It is the agency's intent to address in a subsequent interpretive ruling a number of those situations, such as FCU thrift plans, open end loans, estate loans, prepaid interest, and funds that are withheld from the borrower but are not placed in a deposit account or CI (e.g. in escrow with a third party).

/s/
ROSEMARY BRADY
Secretary
National Credit Union Administration

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